No. 18-457	
Title:	**North Carolina Department of Revenue, Petitioner** **v.** **The Kimberley Rice Kaestner 1992 Family Trust**
Docketed:	October 11, 2018
Linked with 18A210	
Lower Ct:	Supreme Court of North Carolina
Case Numbers:	(307PA15-2)
Decision Date:	June 8, 2018
Questions Presented	

DATE	PROCEEDINGS AND ORDERS
Aug 22 2018	Application (18A210) to extend the time to file a petition for a writ of certiorari from September 6, 2018 to October 9, 2018, submitted to The Chief Justice. **Main Document**
Aug 24 2018	Application (18A210) granted by The Chief Justice extending the time to file until October 9, 2018.
Oct 09 2018	Petition for a writ of certiorari filed. (Response due November 13, 2018) **Petition** **Appendix** **Certificate of Word Count** **Proof of Service**
Oct 16 2018	Waiver of right of respondent The Kimberley Rice Kaestner 1992 Family Trust to respond filed. **Main Document**
Oct 24 2018	DISTRIBUTED for Conference of 11/9/2018.
Oct 31 2018	Response Requested. (Due November 30, 2018)
Nov 30 2018	Brief of respondent Kimberley Rice Kaestner 1992 Family Trust in opposition filed. **Main Document** **Certificate of Word Count** **Proof of Service**
Dec 14 2018	Reply of petitioner North Carolina Department of Revenue filed. **Main Document** **Proof of Service** **Certificate of Word Count**
Dec 19 2018	DISTRIBUTED for Conference of 1/4/2019.

Jan 07 2019	DISTRIBUTED for Conference of 1/11/2019.
Jan 11 2019	Petition GRANTED.
Feb 04 2019	Blanket Consent filed by Petitioner, North Carolina Department of Revenue. **Blanket Consent**
Feb 06 2019	Blanket Consent filed by Respondent, The Kimberley Rice Kaestner 1992 Family Trust. **Blanket Consent**
Feb 11 2019	SET FOR ARGUMENT on Tuesday, April 16, 2019
Feb 22 2019	Joint appendix filed. (Statement of costs filed) **Main Document**
Feb 22 2019	Brief of petitioner North Carolina Department of Revenue filed. **Main Document** **Certificate of Word Count** **Proof of Service**
Feb 28 2019	Brief amici curiae of Tax Law Professors filed. **Main Document** **Certificate of Word Count** **Proof of Service**
Feb 28 2019	Brief amici curiae of Law Professors filed. **Main Document** **Certificate of Word Count** **Proof of Service**
Mar 01 2019	Brief amicus curiae of The American College of Trust & Estate Counsel in support of neither party filed. **Main Document** **Certificate of Word Count** **Proof of Service**
Mar 01 2019	Brief amici curiae of Minnesota, Nineteen Other States, & the District of Columbia filed. **Main Document** **Proof of Service** **Certificate of Word Count**
Mar 01 2019	Brief amici curiae of Constitutional Law Scholars in support of neither party filed. **Main Document** **Certificate of Word Count** **Proof of Service**
Mar 18 2019	Brief of respondent The Kimberley Rice Kaestner 1992 Family Trust filed. (Distributed) **Main Document** **Certificate of Word Count** **Proof of Service**
Mar 20 2019	CIRCULATED
Mar 21 2019	Record requested from the Supreme Court of North Carolina.
Mar 22 2019	Brief amicus curiae of William Fielding, Trustee filed. (Distributed)

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Mar 22 2019	Brief amicus curiae of The New York State Bar Association filed. (Distributed) **Main Document** **Certificate of Word Count** **Proof of Service**
Mar 25 2019	Brief amici curiae of Washington State Tax Practitioners filed. (Distributed) **Main Document** **Certificate of Word Count** **Proof of Service**
Mar 25 2019	Amicus brief of American College of Tax Counsel not accepted for filing. (Corrected version submitted.)
Mar 25 2019	Brief amicus curiae of American College of Tax Counsel filed (March 25, 2019). (Distributed) **Main Document** **Proof of Service** **Certificate of Word Count**
Mar 25 2019	Brief amici curiae of State of South Dakota, et al. filed. (Distributed) **Main Document** **Certificate of Word Count** **Proof of Service**
Mar 25 2019	Brief amicus curiae of Council On State Taxation filed. (Distributed) **Main Document** **Certificate of Word Count** **Proof of Service**
Mar 25 2019	Brief amicus curiae of The Chamber of Commerce of the United States of America filed. (Distributed) **Main Document** **Certificate of Word Count** **Proof of Service**
Mar 25 2019	Brief amicus curiae of Professor Roberta Lea Brilmayer filed. (Distributed) **Main Document** **Certificate of Word Count** **Proof of Service**
Mar 25 2019	Brief amici curiae of Certain State Trust and Bank Associations filed. (Distributed) **Main Document** **Certificate of Word Count** **Proof of Service**
Apr 05 2019	Reply of petitioner North Carolina Department of Revenue filed. (Distributed) **Main Document** **Certificate of Word Count** **Proof of Service**
Apr 16 2019	Argued. For petitioner: Matthew W. Sawchak, North Carolina Solicitor General, Raleigh, N. C. For respondent: David A. O'Neil, Washington, D. C.
Jun 21 2019	Adjudged to be AFFIRMED. Sotomayor, J., delivered the opinion for a unanimous Court. Alito, J., filed a concurring opinion, in which Roberts, C. J., and Gorsuch, J., joined.

NAME	ADDRESS	PHONE

Attorneys for Petitioner

Matthew W. Sawchak Counsel of Record	North Carolina Dept. of Justice P.O. Box 629 Raleigh, NC 27602 msawchak@ncdoj.gov	(919) 716-6400

Party name: NORTH CAROLINA DEPARTMENT OF REVENUE

Attorneys for Respondent

David A. O'Neil Counsel of Record	Debevoise & Plimpton LLP 801 Pennsylvania Avenue N.W. – Suite 500 Washington, DC 20004 daoneil@debevoise.com	(202) 383-8000

Party name: The Kimberley Rice Kaestner 1992 Family Trust

Thomas Dean Myrick	Moore & Van Allen PLLC 100 North Tryon Street, Floor 47 Charlotte, NC 28202 tommyrick@mvalaw.com	704-331-1126

Party name: The Kimberley Rice Kaestner 1992 Family Trust

Other

Stephen Daniel Feldman Counsel of Record	Ellis & Winters LLP 4131 Parklake Avenue, Suite 400 Raleigh, NC 27612 stephen.feldman@elliswinters.com	919-865-7005

Party name: Trust Law Professors

Dirk Giseburt Counsel of Record	Davis Wright Tremaine LLP 920 Fifth Avenue Suite 3300 Seattle, WA 98104 dirkgiseburt@dwt.com	206-757-8049

Party name: Washington State Tax Practitioners

Robert W. Goldman Counsel of Record	Goldman Felcoski & Stone, P.A. 850 Parkshore Drive Suite 203 Naples, FL 34103 rgoldman@gfsestatelaw.com	239 436-1988

Party name: The American College of Trust & Estate Counsel

C. Wells Hall III Counsel of Record	Nelson Mullins Riley & Scarborough LLP 301 S. College Street Suite 2300 Charlotte, NC 28202 wells.hall@nelsonmullins.com	704-417-3000

Party name: American College of Tax Counsel

Robert Matthew Harper
Counsel of Record
New York State Bar Association
One Elk Street
Albany, NY 12207
5184633200

rharper@farrellfritz.com

Party name: The New York State Bar Association

David M. Lehn
Counsel of Record
Withers Bergman LLP
1700 East Putnam Avenue
Suite 400
Greenwich, CT 06870
203-302-4100

david.lehn@withersworldwide.com

Party name: Certain State Trust and Bank Associations

Alan B. Morrison
Counsel of Record
George Washington Law School
2000 H Street NW
Washington, DC 20052
2029947120

abmorrison@law.gwu.edu

Party name: Constitutional Law Scholars

Frederick J. Nicely
Counsel of Record
Counsel On State Taxation
122 C Street NW
Suite 330
Washington, DC 20001-2109
2024845213

fnicely@cost.org

Party name: Council On State Taxation

John Mitchell O'Mahoney
Counsel of Record
Minnesota Attorney General's Office
445 Minnesota Street, Suite 900
St. Paul, MN 55101
6517571216

john.omahoney@ag.state.mn.us

Party name: Minnesota, Nineteen Other States, & the District of Columbia

Walter A. Pickhardt
Counsel of Record
Faegre Baker Daniels LLP
2200 Wells Fargo Center
90 South 7th Street
Minneapolis, MN 55402
612-766-7000

walter.pickhardt@faegrebd.com

Party name: William Fielding, Trustee

Andrew John Pincus
Counsel of Record
Mayer Brown LLP
1999 K Street, NW
Washington, DC 20006
202-263-3220

apincus@mayerbrown.com

Party name: The Chamber of Commerce of the United States of America

Paul S. Swedlund
Counsel of Record
Office of the Attorney General
1302 E. Highway 14, Suite 1
Pierre, SD 57501-8501
6057735402

paul.swedlund@state.sd.us

Party name: State of South Dakota et al

William D Zabel Counsel of Record	Schulte Roth & Zabel LLP 919 Third Avenue New York, NY 10022 william.zabel@srz.com	212-756-2000

Party name: Professor Roberta Lea Brilmayer

Erik R Zimmerman Counsel of Record	Robinson, Bradshaw & Hinson, P.A. 1450 Raleigh Road, Suite 100 Chapel Hill, NC 27517 ezimmerman@robinsonbradshaw.com	919-328-8826

Party name: Tax Law Professors

No. _____

In the

Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,
Petitioner,

v.

THE KIMBERLY RICE KAESTNER 1992 FAMILY TRUST,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF NORTH CAROLINA

PETITION FOR A WRIT OF CERTIORARI

Robert F. Orr
ROBERT F. ORR, PLLC
3434 Edwards Mill Rd.
Suite 112-372
Raleigh, NC 27612
(919) 608-5335

Andrew H. Erteschik
Saad Gul
John M. Durnovich
POYNER SPRUILL LLP
Post Office Box 1801
Raleigh, NC 27602
(919) 783-2895

Matthew W. Sawchak
Solicitor General
Counsel of Record
James W. Doggett
Deputy Solicitor General
NORTH CAROLINA
DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400
msawchak@ncdoj.gov

QUESTION PRESENTED

More than $120 billion of our nation's income flows through trusts. That income is a vital source of tax revenue for the states. Eleven states, including North Carolina, tax trust income when a trust's beneficiaries are state residents.

For the last ninety years, however, this Court has been silent on whether these taxes comport with due process. The Court's last words on the subject come from the *Pennoyer* era of due-process analysis. *Pennoyer v. Neff*, 95 U.S. 714 (1878). As a result, lower courts and state taxing authorities have been searching in vain for modern guidance.

There is now a direct split spanning nine states. Four state courts have held that the Due Process Clause allows states to tax trusts based on trust beneficiaries' in-state residency. Five state courts, including two state supreme courts this year, have concluded that the Due Process Clause forbids these taxes.

The Due Process Clause should not have different meanings in different states—particularly when billions of dollars of state-tax revenue hang in the balance. The question presented to this Court is:

Does the Due Process Clause prohibit states from taxing trusts based on trust beneficiaries' in-state residency?

PARTIES

All parties to the proceedings below are named in the caption.

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OPINIONS BELOW

The opinion of the Supreme Court of North Carolina (App. 1a) is reported at 814 S.E.2d 43 (N.C. 2018).

The opinion of the Court of Appeals of North Carolina (App. 27a) is reported at 789 S.E.2d 645 (N.C. Ct. App. 2016).

The state trial court's decision (App. 41a) is published at 12 CVS 8740, 2015 WL 1880607 (N.C. Super. Ct. Apr. 23, 2015).

JURISDICTION

Petitioner, the North Carolina Department of Revenue, respectfully seeks a writ of certiorari to review a judgment of the Supreme Court of North Carolina pursuant to 28 U.S.C. § 1257(a). The Supreme Court of North Carolina issued its opinion on June 8, 2018.

On August 24, 2018, Chief Justice Roberts extended the time to file this petition until October 9, 2018. *North Carolina Dep't of Revenue v. Kimberly Rice Kaestner Family Trust*, No. 18A210 (U.S. Aug. 24, 2018).

CONSTITUTIONAL PROVISIONS

The Due Process Clause of the Fourteenth Amendment provides that "[n]o state shall . . . deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend. XIV, § 1.

INTRODUCTION

This case asks whether the Due Process Clause prohibits states from taxing trusts based on trust beneficiaries' in-state residency—a question on which nine state courts have split.

Because of the Tax Injunction Act, this federal constitutional question is usually litigated in state courts.[1] State courts are divided in their answers to this question, however, because they lack modern guidance from this Court.

Many decades have passed since this Court has addressed the due-process limits of trust taxation. Although the Court has recently considered a number of due-process cases that address states' jurisdiction to adjudicate, those cases do not offer clear guidance on the due-process limits on trust taxation. State courts have struggled to fill this jurisprudential void.

Part of that struggle stems from the unique nature of trusts—entities that frustrate conventional due-process tests. Unlike an individual, a trust is a legal abstraction: a fiction created to represent the tripartite relationship among a settlor, a trustee, and a beneficiary. George Gleason Bogert, *The Law of Trusts and Trustees* § 1 (3d ed. 2008). For this reason, a trust's physical location is debatable.

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[1] The Tax Injunction Act, 28 U.S.C. § 1341 (2012), provides that federal courts "shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

Because of these unusual features of trusts, courts that have applied rigid, formalistic rules to trusts have reached unjust conclusions.

In the decision below, for example, a majority of the North Carolina Supreme Court concluded that a trust and its beneficiaries are legally separate—in other words, that beneficiaries are outsiders to a trust. On that basis, the majority expressly disregarded the trust beneficiaries' in-state residency and other contacts with North Carolina. That analysis led the majority to conclude that the trust at issue lacked a constitutionally sufficient connection with the state. Thus, the majority held that the Due Process Clause barred North Carolina from taxing undistributed income that the trust earned and held for the benefit of the beneficiaries.

With that decision, North Carolina joined the ranks of eight other states that have reached conflicting decisions on the question presented here. Five states have concluded that the Due Process Clause forbids states from taxing trusts based on trust beneficiaries' in-state residency. Four states have concluded the opposite.

Neither side of the split involves uniform reasoning. Some state courts have followed this Court's trust-taxation precedents that predate *International Shoe Co. v. Washington*, 326 U.S. 310 (1945). Other state courts have looked to this Court's modern due-process decisions—for example, cases involving jurisdictional challenges by tort defendants—but have struggled to apply those precedents in the unique context of trust taxation. Moreover, the courts on both sides of the split have disagreed internally, with seven jurists dissenting from the opinions.

This split has serious consequences for state-tax revenues and, more broadly, for federalism principles.

Financially, the states that have barred taxation face sharp cuts to their tax revenues. In fact, these states are exposed to hundreds of millions of dollars of potential claims for tax refunds. In North Carolina, for example, trustees are already pursuing refunds in the wake of the decision below.

In addition, the five state courts that have barred these taxes have undermined important federalism principles. By grounding their decisions in the federal Due Process Clause, those courts have not only forbidden a common form of taxation within their own borders, but have also called it into question in other states.

Because these decisions are based on the federal Due Process Clause, no single state can resolve the confusion. The direct split, and the problems associated with it, will only worsen without this Court's intervention.

STATEMENT

I. How and Why States Tax Trust Income

Generally, if a trust distributes income to a beneficiary, the beneficiary (as opposed to the trust itself) is taxed on that income. 2 Jerome Hellerstein & Walter Hellerstein, *State Taxation* ¶ 20.09, at 20-148 (3d ed. 2003). But when a trust earns income that it holds for its beneficiary, the trust itself is taxed. *Id.*

North Carolina's statute assesses taxes "on the amount of the taxable income of the . . . trust that is for the benefit of a resident of [the] State." N.C. Gen. Stat. § 105-160.2 (2017). Before this lawsuit, that statute (or one of its predecessors) had been in force and unchallenged since 1923.[2]

Taxing a trust's undistributed income based on the trust beneficiaries' in-state residency serves two vital functions.

First, the revenue pays for the many services that states provide to those in-state beneficiaries. These services protect beneficiaries as the undistributed income in their trusts grows. The value of those services is considerable. *See South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2096 (2018) (observing that state taxes "fund the police and fire departments," "maintain the public roads and municipal services," and "support the sound local banking institutions" enjoyed by residents).

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[2] In North Carolina, as in most states, the taxable income of an estate or trust "is the same as taxable income for such an estate or trust under the provisions of the [Internal Revenue] Code," with adjustments similar to the adjustments that apply to individual taxation. N.C. Gen. Stat. § 105-160.2 (2017).

Second, taxing a trust's undistributed income ensures that beneficiaries cannot permanently shelter income earned for their benefit. In the absence of a statute like North Carolina's, a beneficiary could enjoy the protections of a state for most of her life, then avoid taxation by relocating to a non-taxing state before taking a distribution.

For these reasons, eleven states (including North Carolina) tax trusts based on trust beneficiaries' in-state residency.

II. The Kaestner Trust

The Kimberly Rice Kaestner 1992 Family Trust is an irrevocable, *inter vivos* (non-testamentary) trust that was created for the benefit of Kimberly Rice Kaestner and her children. During the relevant period, the Trust contained more than $13 million in assets.

The Trust was created in New York. Its trustee was a resident of Connecticut during the tax years at issue. During those years, Ms. Kaestner and her children were residents of North Carolina.

North Carolina law provides that the state's Department of Revenue may tax trust income "that is for the benefit of a resident of this State." N.C. Gen. Stat. § 105-160.2. Thus, the Department assessed taxes on the undistributed income that accumulated in the Trust from 2005 to 2008.

The Trust paid roughly $1.28 million in taxes under protest. Then it filed this lawsuit.

III. The Trust's Constitutional Challenge

The Trust brought this lawsuit as a constitutional challenge in state court. Among its claims, the Trust asserted that North Carolina had

violated the Due Process Clause by assessing taxes on undistributed income held by the Trust for the benefit of Ms. Kaestner and her children.[3] The Trust argued that the Trust itself—as opposed to the Trust's beneficiaries—did not have a constitutionally sufficient connection with North Carolina.

The state trial court concluded that North Carolina's assessment of taxes on the Trust violated the Due Process Clause, and therefore ordered a refund.[4] App. 69a. The North Carolina Court of Appeals affirmed. App. 27a.

In a 6-1 decision, the North Carolina Supreme Court affirmed the decision of the court of appeals. App. 1a. The majority held that the in-state residence of the Trust's beneficiaries is not a sufficient connection with North Carolina for due-process purposes.

The majority first characterized a trust as something separate from its beneficiaries—reasoning, in essence, that trust beneficiaries are

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[3] In addition to the Trust's due-process claim, the Trust also brought claims under the Commerce Clause and under the North Carolina Constitution's law-of-the-land clause. That state-constitutional claim is dependent on the Trust's federal due-process claim. *See, e.g.*, *Tully v. City of Wilmington*, 810 S.E.2d 208, 216–17 (N.C. 2018) (explaining that North Carolina's "'law of the land' [clause] is synonymous with 'due process of law,' a phrase appearing in the Federal Constitution and the organic law of many states").

[4] In addition, the trial court held that the Department's assessment of taxes on the Trust violated the Commerce Clause—an issue that neither of the state appellate courts ultimately reached.

third parties to a trust. App. 13a. Next, the majority borrowed principles from this Court's decision in *Walden v. Fiore*, 571 U.S. 277 (2014), which held, in the context of a tort claim, that third parties' contacts with a forum state do not matter for due-process purposes.[5] *Id.* Finally, the court merged these two points and concluded that the Trust's beneficiaries' contacts with North Carolina do not matter in a due-process analysis. On this basis, the court held that North Carolina's trust-tax statute was unconstitutional as applied to the Trust. App. 18a.

Justice Sam J. Ervin, IV, dissented. Criticizing the majority's "formalistic, presence-focused" approach, Justice Ervin concluded that the beneficiaries' in-state residency "has some bearing on the proper performance of the required due process analysis." App. 24a.

Justice Ervin viewed this Court's due-process precedent as requiring a wider-ranging analysis of the Trust's connection with North Carolina—an analysis that would give weight to the in-state residency of the Trust's beneficiaries. *Id.* Applying that analysis, Justice Ervin concluded that the Trust had a constitutionally sufficient connection with North Carolina—a connection that brought the Trust within North Carolina's taxing jurisdiction. *Id.*

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[5] The majority also cited *Hanson v. Denckla*, 357 U.S. 235 (1958), to support this general proposition about third-party contacts. *Hanson* involved a trust, but the issue there was whether a beneficiary's contacts with a state were sufficient to establish adjudicative jurisdiction over a *trustee*, not a trust. *Id.* at 253. Thus, *Hanson* offers no guidance on the question presented here.

REASONS FOR GRANTING THE PETITION

I. There is a direct split among nine state courts on the question presented.

A trust is a legal abstraction that evades conventional due-process tests. *See infra* pp. 15–18. The abstract character of trusts, coupled with a lack of contemporary guidance from this Court, has led to confusion among the state courts that have grappled with the question presented. The confusion has produced a direct split that spans nine states.

Four state courts have concluded that the Due Process Clause allows states to tax trusts based on trust beneficiaries' in-state residency:

- In *McCulloch v. Franchise Tax Board*, 390 P.2d 412 (Cal. 1964), the California Supreme Court found no constitutional prohibition against taxing a trust based on the trust beneficiary's in-state residence. The court began by noting that this Court "ha[d] not yet had occasion to decide the validity of a tax with respect to [a trust's] accumulated income where the trustee is a nonresident and the tax is founded on the residence of the beneficiary." *Id.* at 418. The court went on to hold that a beneficiary's state of residence can tax the trust because "that state renders to the beneficiary . . . protection incident to his eventual enjoyment of such accumulated income." *Id.* at 419.

- In *Westfall v. Director of Revenue*, 812 S.W.2d 513 (Mo. 1991), the Missouri Supreme Court held that Missouri could tax a trust's undistributed income because the trust at issue had several points of contact with the state, one

of which was the presence of an in-state beneficiary. *Id.* at 514. Two justices dissented, opining that the tax was unconstitutional because the trustee, the "legal owner of the trust property," was a nonresident. *Id.* at 517 (Blackmar, J., dissenting).

- In *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 802 (Conn. 1999), the Connecticut Supreme Court held that states can tax undistributed trust income based on trust beneficiaries' in-state residency. The court emphasized the "protection and benefits" that states provide beneficiaries and found that the beneficiary's in-state residency was the "critical link" justifying taxation. *Id.* at 802 n.25. Two justices dissented, focusing on the fact that the income at issue "was produced outside the state of Connecticut." *Id.* at 807 (McDonald, J., dissenting).
- In *Linn v. Department of Revenue*, 2 N.E.3d 1203, 1209 (Ill. App. Ct. 2013), the Illinois Appellate Court favorably cited Connecticut's *Gavin* decision and held that the critical link between a state and a trust for tax purposes is the residence of the beneficiary.[6]

In contrast, the courts of five states (including the North Carolina Supreme Court in this case) have concluded that the Due Process Clause prohibits states from taxing trusts based on trust beneficiaries' in-state residency:

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[6] *Linn* ultimately held that the state could not tax a trust merely because the trust's settlor had been an Illinois resident. 2 N.E.3d at 1210.

- In *Mercantile-Safe Deposit & Trust Co. v. Murphy*, 203 N.E.2d 490, 491 (N.Y. 1964), the New York Court of Appeals held that the Due Process Clause prohibited New York from taxing the income of a trust administered in Maryland. The court reached this conclusion even though the trust beneficiary was a New York resident.
- In *Potter v. Taxation Division Director*, 5 N.J. Tax 399, 405 (N.J. Tax Ct. 1983), the New Jersey Tax Court held that the "fact that contingent beneficiaries are domiciled in New Jersey does not constitute a contact sufficient to empower New Jersey to tax undistributed trust income where the contingent beneficiaries have no right to the undistributed trust income."[7]
- In *Blue v. Department of Treasury*, 462 N.W.2d 762, 764 (Mich. Ct. App. 1990), the Michigan Court of Appeals held that only the presence of "the trustee [or] trust property . . . within the state" can justify taxation of a trust's income.
- The North Carolina Supreme Court concluded here that Ms. Kaestner's in-state residency could not justify taxing the Trust. App. 18a.
- A month after the North Carolina Supreme Court decided this case, the Minnesota Supreme Court likewise concluded that a beneficiary's in-state residence is not a sufficient basis for

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[7] Part of the holding in *Potter* has been superseded by statute, as recognized in *Heico Corp. v. Taxation Div. Dir.*, 20 N.J. Tax 106 (N.J. Tax Ct. 2002). However, the New Jersey Tax Court continues to rely on *Potter*'s holding on trust taxation. *See Residuary Trust A v. Dir.*, 27 N.J. Tax 68 (N.J. Tax Ct. 2013).

taxation. The court reasoned that "the Minnesota residency of [the] beneficiary . . . does not establish the necessary minimum connection to justify taxing the trust's income." *Fielding v. Comm'r of Revenue*, 916 N.W.2d 323, 331 (Minn. 2018). Two justices dissented, focusing on the beneficiaries' residency. *See id.* at 334 (Lillehaug, J., dissenting).

In sum, there is a direct split among nine state courts on an important constitutional question. This split has intensified recently, culminating in three decisions in the past five years. That direct split, by itself, shows the need for this Court's review.

II. The question presented has significant implications for the states.

The question presented has significant implications for the states in at least two ways. First, the question presented affects billions of dollars in state-tax revenue. Second, the question presented involves important principles of federalism.

A. The question presented affects an enormous amount of state-tax revenue.

In 2014 alone, trusts filed more than 2.7 million federal tax returns.[8] Collectively, those trusts

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[8] *See* Internal Revenue Service, *SOI Tax Stats—Fiduciary Returns—Sources of Income, Deductions, and Tax Liability—Type of Entity: 2014*, *available at* https://www.irs.gov/statistics/soi-tax-stats-fiduciary-returns-sources-of-income-deductions-and-tax-liability-by-type-of-entity.

This figure includes returns filed on behalf of complex trusts, simple trusts, grantor trusts, qualified-disability trusts, split-interest trusts, and pooled-income funds. It does not include

reported income of more than $120 billion.[9] Taxes on these billions of dollars are a critical source for funding states' essential government services.

Nearly every state taxes trust income.[10] At least eleven states currently tax undistributed trust income when a trust beneficiary lives in the taxing state.[11] Until the state supreme court's decision in this case, North Carolina had assessed these taxes since 1923. *See* Act of Mar. 3, 1923, ch. 4, § 205, 1923 N.C. Sess. Laws 67, 128.

With decisions like the one in this case, however, the states collectively stand to lose hundreds of millions of dollars in state-tax revenue *annually*—losses that will reach billions of dollars over the next decade alone. In North Carolina, the Department has already received more than 450 contingent income-tax returns from trusts that are awaiting the outcome of this petition.

In short, the question presented has enormous implications for the fiscal health of many states.

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returns filed on behalf of decedents' estates, Chapter 7 bankruptcy estates, and Chapter 11 bankruptcy estates.

[9] *See id.*

[10] *2017 Trust Nexus Survey Covering General Trust Nexus Policies*, Daily Tax Rep. (BNA) No. 175, at 10–11 (Oct. 30, 2017).

[11] Those states (other than North Carolina) are Alabama, *see* Ala. Code § 40-18-1(33); California, *see* Cal. Rev. & Tax. Code § 17742(a); Connecticut, *see* Conn. Gen. Stat. Ann. § 12-701(a)(4); Georgia, *see* Ga. Code Ann. § 48-7-22(a)(1)(A); Missouri, *see* Mo. Rev. Stat. § 143.331(1)(b); Montana, *see* Mont. Admin. R. 42.30.101(16); North Dakota, *see* N.D. Admin. Code 81-03-02.1-04; Ohio, *see* Ohio Rev. Code Ann. § 5747.01; Rhode Island, *see* 44 R.I. Gen. Laws § 44-30-5(c); and Tennessee, *see* Tenn. Code Ann. § 67-2-110(a).

B. The question presented involves important principles of federalism.

As the Framers recognized, the states have always "possessed an independent and uncontrollable authority to raise their own revenues for the supply of their own wants." The Federalist No. 32, at 197 (Alexander Hamilton) (Clinton Rossiter ed., 1961); *see also Wayfair*, 138 S. Ct. at 2096 (describing state taxes as a "valid exercise of the States' sovereign power").

This broad power to tax is a cornerstone of federalism. As Chief Justice Marshall noted in *McCulloch v. Maryland*, "the power of taxing the people and their property is essential to the very existence of government." 17 U.S. (4 Wheat.) 316, 428 (1819). He stressed that this power covers "[a]ll subjects over which the sovereign power of a state extends." *Id.* at 429.

Acting on these principles, this Court has cautioned that the "modes adopted [by the states] to enforce the taxes levied should be interfered with as little as possible." *Dows v. City of Chicago*, 78 U.S. 108, 110 (1871).

Now, however, five state courts have reached federal constitutional decisions that slight these principles of federalism. Those courts have rejected a common mode of trust taxation. They have also cast doubt on the constitutionality of that mode of taxation for the other states that have adopted it, as well as states that may consider assessing these taxes in the future. Together, these decisions mark "an extraordinary imposition by the Judiciary on States' authority to collect taxes and perform critical public functions." *Wayfair*, 138 S. Ct. at 2095 (describing the

former "physical-presence rule" under the Commerce Clause).

As these points show, the question presented raises important fiscal concerns and involves important federalism principles.

III. This case offers the Court an opportunity to modernize its trust-taxation jurisprudence.

A. The absence of modern precedent on trust taxation has caused confusion.

It has been more than seventy years since the Court addressed the power of states to tax trusts. *See Greenough v. Tax Assessors of Newport*, 331 U.S. 486 (1947); Jeffrey Schoenblum, *Strange Bedfellows: The Federal Constitution, Out-of-State Nongrantor Accumulation Trusts, and the Complete Avoidance of State Income Taxation*, 67 Vand. L. Rev. 1945, 1968 (2014). Given the lack of contemporary guidance from the Court, state courts are confused over how to apply the Due Process Clause in the context of trust taxation.

Some state courts have looked to this Court's early decisions on trust taxation—decisions from the era of *Pennoyer v. Neff*, 95 U.S. 714. Other state courts, like the North Carolina Supreme Court in this case, have attempted to apply the Court's more recent due-process decisions. In both sets of cases, the courts' opinions have shown the need for more direct guidance from this Court.

Some state courts that have relied on older due-process precedents have followed this Court's 1929 decision in *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83. In *Safe Deposit*, this Court held that Virginia could not assess property taxes on trust property that

was held in Maryland for a Virginia beneficiary. *Id.* The Court premised this holding on its assumption that the Due Process Clause does not allow multiple states to tax the same intangible property. *Id.* at 94.

Safe Deposit, however, does not involve a modern due-process analysis. It was decided under the rigid, presence-based regime of *Pennoyer v. Neff*. It was decided fifteen years before *International Shoe*, which replaced *Pennoyer*'s rigid test with the more flexible "minimum contacts" test. 326 U.S. at 316. It was also decided long before *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), which rejected "formalistic tests" for assessing jurisdiction to tax.[12] *Id.* at 307–08 (eliminating the former "physical presence" rule under the Due Process Clause).

Furthermore, *Safe Deposit* was premised on the notion that the Due Process Clause prohibits double taxation—a prohibition that the Court later abandoned in *Curry v. McCanless*, 307 U.S. 357, 363 (1939). With that linchpin removed, *Safe Deposit* is no longer good law. *See, e.g.*, *Gavin*, 733 A.2d at 803 (noting that the double-taxation concern was "[c]entral to the Court's reasoning in *Safe Deposit*," but that this rationale "has long been abandoned as a limitation on taxation under the due-process clause"); *Kaestner*, 814 S.E.2d at 53 (Ervin, J., dissenting) (opining that *Safe Deposit* did not support, much less compel, the majority's decision); *see also McCullough*, 390 P.2d at 418 (acknowledging *Safe Deposit* without following it).

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[12] Although both *International Shoe* and *Quill* were cases involving state taxes, neither case involved trusts, much less due-process limits on trust taxation. Thus, neither decision answers the question presented here.

Despite these points, a number of state-court majorities and dissents have followed *Safe Deposit*. *See Blue*, 462 N.W.2d at 764; *Fielding*, 916 N.W.2d at 330; *Fielding*, 916 N.W.2d at 337 n.4 (Lillehaug, J., dissenting); *Murphy*, 203 N.E.2d at 490. They have done so largely without asking whether *Safe Deposit* has been displaced by the Court's modern due-process decisions.

State courts that have relied on the Court's more modern due-process decisions have shown equal confusion.

The North Carolina Supreme Court's decision in this case is a prime example. The majority borrowed general principles from recent adjudicative-jurisdiction cases that are silent on trust taxation and the unique relationship between a trust and a beneficiary. App. 13a.

Most notably, the state supreme court relied on *Walden v. Fiore*, 571 U.S. 277, a case that decided whether two Nevada gamblers could bring a tort lawsuit in Nevada against a Georgia-based law enforcement agent who seized their gambling winnings in Georgia. The *Walden* Court explained that a plaintiff cannot use the forum contacts of a "third party"—there, the plaintiffs themselves—to justify personal jurisdiction over a defendant. *Id.* at 286.

Walden's rationale does not apply in the context of a trust and its beneficiaries, where the beneficiary is not a genuine third party. Unlike the brief interaction between the tortfeasor and the plaintiffs in *Walden*, the fiduciary relationship between a trustee and a beneficiary is enduring; indeed, such a relationship often lasts many decades. *See Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 480 (1985) (recognizing that

long-term relationships can serve as a basis for jurisdiction, depending on the quality and nature of those relationships). And unlike the adverse relationship between the tortfeasor and the plaintiffs in *Walden*, the relationship between a trust and its beneficiaries is symbiotic. After all, the beneficiaries are why the trust exists. *See infra* p. 19.

In sum, neither the Court's pre-*International Shoe* decisions nor its modern decisions have resolved the question presented. The lack of on-point decisions has caused confusion among state courts.

B. *Wayfair* is a model for modernizing this Court's trust-taxation jurisprudence.

In the recent *Wayfair* decision, the Court updated its Commerce Clause jurisprudence to reflect present-day realities in the context of sales taxes. This case offers the Court a similar opportunity to modernize its due-process jurisprudence in the context of trust taxes.

In *Wayfair*, the Court reaffirmed *Quill*'s holding that a taxpayer "need not have a physical presence in a state to satisfy the demands of due process." *Wayfair*, 138 S. Ct. at 2084–85. The Court expressly rejected "arbitrary, formalistic" distinctions that lower courts had used to "prevent States from collecting taxes." *Id.* at 2094. The Court also condemned "judicially created tax shelter[s]." *Id.*

This case gives the Court a similar opportunity to modernize the constitutional analysis of trust taxation in ways that parallel *Wayfair*.

First, like *Wayfair*, this case presents an opportunity for the Court to reject "arbitrary, formalistic" distinctions that prevent states from assessing taxes. The North Carolina Supreme Court's

formalistic rationale—the idea that trust beneficiaries' contacts with a taxing state are not contacts of the trust itself—is an outdated notion, reminiscent of the physical-presence rule that was retired in *Wayfair*.

The question presented here calls for a more flexible approach to trust taxation—one that expressly recognizes that a beneficiary is no stranger to a trust. This approach is consistent with the Court's existing due-process jurisprudence, which requires only "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Quill*, 504 U.S. at 306 (quoting *Miller Bros. v. Maryland*, 347 U.S. 340, 344–45 (1954)).

In the context of trust taxation, the required "minimum connection" is the residency of the beneficiary in the taxing state. This residency creates a "definite link" between the trust and the taxing state; indeed, if not for the in-state beneficiary who consumes the resources of the taxing state, the trust itself could not exist. *See* Bogert, *supra*, § 543 (noting that a trust fails for lack of a beneficiary); Restatement (Third) of Trusts § 44 (Am. Law Inst. 2003) (same).

The definite link is even stronger when one considers the vested interest that the beneficiary has in the trust. This Court has characterized that interest as an "estate in and to property" of the trust. *Blair v. Comm'r*, 300 U.S. 5, 14 (1937) (quoting *Brown v. Fletcher*, 235 U.S. 589, 599 (1915)). In other words, the trustee has legal ownership of property held in the trust, but the beneficiary enjoys equitable ownership of that property—"an actual property interest in the

subject-matter of the trust." *Commonwealth v. Stewart*, 12 A.2d 444, 446–47 (Pa. 1940), *aff'd mem.*, 312 U.S. 649 (1941); *see also* Bogert, *supra*, § 114.

As these points show, the North Carolina Supreme Court's formalistic "separateness" theory clashes with this Court's modern due-process jurisprudence and overlooks the essential nature of trusts. This case presents an ideal opportunity for the Court to reject these arbitrary, formalistic distinctions and adopt an approach that is more appropriate for analyzing trust taxation under the Due Process Clause.

Second, like *Wayfair*, this case presents an opportunity for the Court to eliminate a "judicially created tax shelter." 138 S. Ct. at 2094.

Five state courts have now concluded that taxing trusts based on trust beneficiaries' in-state residency is unconstitutional. In those five states, beneficiaries like Ms. Kaestner can establish residency, consume state resources, and accept other protections from the state, while income earned for their benefit goes untaxed. *See id.* at 2096 (observing that state taxes fund local police and fire departments, public roads, municipal services, local banking, and the court system for the benefit of residents); *see also Gavin*, 733 A.2d at 795 (recognizing that trusts benefit from states' protection of their beneficiaries); *McCullough*, 390 P.2d at 419 (same).

These state benefits are not hypothetical. For example, one of the Kaestner Trust's main purposes was to provide for Ms. Kaestner's education. That purpose was fulfilled when Ms. Kaestner earned a master's degree at UNC-Chapel Hill. Her university education was subsidized by North Carolina's taxpayers. And if Ms. Kaestner died in the absence of

contingent trust beneficiaries, her interest would pass through North Carolina's probate system—another benefit funded by North Carolina's taxpayers.

Worse still, the five state-court decisions that have rejected jurisdiction have enabled beneficiaries to avoid paying state taxes *altogether*. Beneficiaries like Ms. Kaestner can now accumulate income in their trusts over several decades, avoid taxes on that income, and then, before taking a distribution from their trusts, simply move—even temporarily—to a state like Florida that does not assess income taxes. Nothing would stop these beneficiaries from returning the following year to their home state to resume residency after taking tax-free distributions from their trusts.

As one commentator put it, decisions like the one in this case "facilitate an extraordinary stratagem by which wealthy individuals are able to avoid all state income taxes on investment income through the use of a carefully crafted out-of-state trust." Schoenblum, *supra*, at 1997.

Under any notion of "fair play and substantial justice," *Int'l Shoe*, 326 U.S. at 320, this "judicially created tax shelter" is one that warrants elimination. *Wayfair*, 138 S. Ct. at 2094.

* * *

The Due Process Clause should not have different meanings across nine states, especially when billions of dollars in state-tax revenue hang in the balance. Without guidance from this Court, the split at issue here will continue to worsen, with serious consequences for the states.

For these reasons, the question presented warrants this Court's review.

CONCLUSION

The petition should be granted.

Respectfully submitted,

JOSHUA H. STEIN
Attorney General

/s/ Matthew W. Sawchak
Matthew W. Sawchak
Solicitor General
Counsel of Record
James W. Doggett
Deputy Solicitor General
NORTH CAROLINA
DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400

Robert F. Orr
ROBERT F. ORR, PLLC
3434 Edwards Mill Rd.
Suite 112-372
Raleigh, NC 27612
(919) 608-5335

Andrew H. Erteschik
Saad Gul
John M. Durnovich
POYNER SPRUILL LLP
Post Office Box 1801
Raleigh, NC 27602
(919) 783-2895

October 9, 2018

No. _____

In the

Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,
Petitioner,

v.

THE KIMBERLY RICE KAESTNER 1992 FAMILY TRUST,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF NORTH CAROLINA

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

Robert F. Orr
ROBERT F. ORR, PLLC
3434 Edwards Mill Rd.
Suite 112-372
Raleigh, NC 27612
(919) 608-5335

Andrew H. Erteschik
Saad Gul
John M. Durnovich
POYNER SPRUILL LLP
Post Office Box 1801
Raleigh, NC 27602
(919) 783-2895

Matthew W. Sawchak
Solicitor General
Counsel of Record
James W. Doggett
Deputy Solicitor General
NORTH CAROLINA
DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400
msawchak@ncdoj.gov

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[ENTERED JUNE 8, 2018]

IN THE SUPREME COURT OF
NORTH CAROLINA

No. 307PA15-2

Filed 8 June 2018

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST

v.

NORTH CAROLINA DEPARTMENT
OF REVENUE

On discretionary review pursuant to N.C.G.S. § 7A-31 of a unanimous decision of the Court of Appeals, ___ N.C. App. ___, 789 S.E.2d 645 (2016), affirming an opinion and order of summary judgment dated 23 April 2015 entered by Judge Gregory P. McGuire, Special Superior Court Judge for Complex Business Cases appointed by the Chief Justice pursuant to N.C.G.S. § 7A-45.4, in Superior Court, Wake County. Heard in the Supreme Court on 11 October 2017.

Moore & Van Allen PLLC, by Thomas D. Myrick, Neil T. Bloomfield, Jonathan M. Watkins, and Kara N. Bitar, for plaintiff-appellee.

Joshua H. Stein, Attorney General, by Matthew W. Sawchak, Solicitor General, Tenisha S. Jacobs, Special Deputy Attorney General, and James W. Doggett, Deputy Solicitor General; and Law Office of Robert F. Orr, by Robert F. Orr, for defendant-appellant.

JACKSON, Justice.

In this case we consider whether defendant North Carolina Department of Revenue could tax the income of plaintiff The Kimberly Rice Kaestner 1992 Family Trust pursuant to N.C.G.S. § 105-160.2 solely based on the North Carolina residence of the beneficiaries during tax years 2005 through 2008. Because we determine that plaintiff did not have sufficient minimum contacts with the State of North Carolina to satisfy due process requirements of the Fourteenth Amendment to the United States Constitution and Article I, Section 19 of the Constitution of North Carolina, we conclude that the taxes at issue were collected unconstitutionally and, therefore, affirm the decision of the Court of Appeals affirming the North Carolina Business Court's 23 April 2015 Opinion and Order on Motions for Summary Judgment in favor of plaintiff.

As the Business Court noted, the underlying, material facts of this case as established by the evidence in the record are not in dispute. The Joseph Lee Rice, III Family 1992 Trust was created in New York in 1992 for the benefit of the children of the settlor Joseph Lee Rice, III pursuant to a trust agreement between Rice and the initial trustee, William B. Matteson. In 2005 Matteson was replaced as trustee by David Bernstein, who was a resident of Connecticut. Bernstein remained in the position of trustee and remained a Connecticut resident during the entire period of time relevant to this case. The trust was and is governed by the laws of the State of New York, of which Rice was a resident. No party to the trust resided in North Carolina until Rice's daughter and a primary beneficiary of the trust, Kimberly Rice Kaestner, moved to North Carolina in 1997.

On 30 December 2002, the trust was divided into three share sub-trusts one each for the benefit of Rice's three children, including Kaestner. The sub-trusts were divided into three separate trusts in 2006 by Bernstein for administrative convenience. Plaintiff is the separate share trust formed for the benefit of Kaestner and her three children, all of whom resided in North Carolina during the tax years at issue.

During the tax years at issue, the assets held by plaintiff consisted of various financial investments, and the custodians of those assets were located in Boston, Massachusetts. Documents related to plaintiff such as ownership documents, financial books and records, and legal records were all kept in New York. All of plaintiff's tax returns and accountings were prepared in New York.

None of the beneficiaries of plaintiff had an absolute right to any of plaintiff's assets or income because distributions could only be made at the discretion of Bernstein, who had broad authority to manage the property held by plaintiff. No distributions were made to beneficiaries in North Carolina, including Kaestner, during the tax years at issue; however, in January 2009, plaintiff loaned $250,000 to Kaestner at Bernstein's discretion to enable her to pursue an investment opportunity. This loan was repaid.

The terms of the original trust provided that the trustee was to distribute the trust assets to Kaestner when she reached the age of forty. Before her fortieth birthday on 2 June 2009, Kaestner had conversations with her father and Bernstein about whether she wished to receive the trust assets on

that date. Ultimately, she requested to extend the trust, and accordingly, Bernstein transferred the assets of plaintiff into a new trust, the KER Family Trust, in 2009. That transfer occurred after the tax years at issue, and KER Family Trust is not a party to this case.

In managing plaintiff, Bernstein provided Kaestner with accountings of trust assets, and she received legal advice regarding plaintiff from Bernstein and his firm. Kaestner and her husband also met with Bernstein in New York to discuss investment opportunities for the trust and whether Kaestner desired to receive income distribution as set forth in the original trust agreement.

During tax years 2005 through 2008, defendant taxed plaintiff on income accumulated each year, regardless of whether any of that income was distributed to any of the North Carolina beneficiaries. Plaintiff sought a refund of those taxes totaling more than $1.3 million, including $79,634.00 paid for 2005, $106,637.00 paid for 2006, $1,099,660.00 paid for 2007, and $17,241.00 paid for 2008. Defendant denied the refund request on 11 February 2011.

On 21 June 2012, plaintiff filed a complaint in Superior Court, Wake County, alleging that defendant wrongfully denied plaintiff's request for a refund because N.C.G.S. § 105-160.2 is both unconstitutional on its face and as applied to collect income taxes from plaintiff during those tax years. Plaintiff claimed that the taxes collected pursuant to section 105-160.2 violate the Due Process Clause because plaintiff did not have sufficient minimum contacts with the State of North Carolina. Plaintiff

also claimed that the taxes violate the Commerce Clause on several grounds, including that the tax was not applied to an activity with a substantial nexus to the taxing state. Plaintiff claimed that consequently, the tax also violated Article I, Section 19 of the state constitution. Based on these claims, plaintiff requested a declaration that section 105-160.2 is unconstitutional and an order from the court requiring defendant to refund any taxes, penalties, and interest paid by plaintiff for tax years 2005 through 2008, and enjoining defendant from enforcing any future assessments against plaintiff pursuant to section 105-160.2. Subsequent evidence indicated that penalties were assessed against plaintiff for tax years 2005 and 2006. These penalties were not paid by plaintiff and were ultimately waived at plaintiff's request, rendering moot that specific portion of plaintiff's claim for relief.

In accord with N.C.G.S. § 7A-45.4(b), this case was designated as a mandatory complex business case by the Chief Justice on 19 July 2012. On 11 February 2013, the Business Court issued an Opinion and Order on Defendant's Motion to Dismiss in which it granted the motion as to plaintiff's claim for injunctive relief, but denied the motion as to plaintiff's constitutional claims.

Relevant to this appeal, plaintiff filed a motion for summary judgment on its constitutional claims on 8 July 2014, and defendant filed its own motion for summary judgment on 4 September 2014. In its Opinion and Order on Motions for Summary Judgment, the Business Court observed that when a taxed entity such as plaintiff is not physically present in the taxing state, the taxed entity must

"purposefully avail[ ] itself of the benefits of an economic market in the forum state" for the tax to satisfy due process requirements. *Kimberley Rice Kaestner 1992 Family Trust v. N.C. Dep't of Revenue*, No. 12 CVS 8740, 2015 WL 1880607, at *4 (N.C. Super. Ct. Wake County (Bus. Ct.) Apr. 23, 2015), *aff'd*, ___, N.C. App. ___, 789 S.E.2d 645 (2016) (quoting *Quill Corp. v. North Dakota*, 504 U.S. 298, 307, 112 S. Ct. 1904, 1910 (1992)). Determining that plaintiff did not purposefully avail itself of the benefits of the taxing state based solely on the beneficiaries' residence in North Carolina, the Business Court concluded that the provision of section 105-160.2 allowing taxation of trust income "that is for the benefit of a resident of this State," N.C.G.S. § 105-160.2 (2005), violated both the Due Process Clause and Article I, Section 19 of the state constitution as applied to plaintiff. Applying the four-pronged analysis for determining the constitutionality of a tax pursuant to the Commerce Clause as set forth by the United States Supreme Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 1079 (1977), the Business Court also determined that the same provision of section 105-160.2 violated the Commerce Clause as applied to plaintiff. Therefore, the Business Court denied defendant's motion for summary judgment, granted plaintiff's motion for summary judgment, and ordered that any taxes and penalties paid by plaintiff pursuant to section 105-160.2 be refunded with interest.

Defendant noticed its appeal to the Court of Appeals on 22 May 2015. Before that court, defendant challenged the substantive conclusions of the Business Court that taxation of the trust based

solely on the residency of the beneficiaries violated both the Due Process and Commerce Clauses as applied to plaintiff. *Kaestner 1992 Family Tr. v. N.C. Dep't of Revenue*, ___ N.C. App. ___, ___, 789 S.E.2d 645, 647-48 (2016). Like the Business Court, the Court of Appeals also reasoned from the United States Supreme Court's guidance that "[t]he Due Process Clause requires [(1)] some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax, and [(2)] that the income attributed to the State for tax purposes must be rationally related to values connected with the taxing State." *Id.* at ___, 789 S.E.2d at 649 (second and third alterations in original) (quoting *Quill*, 504 U.S. at 306, 112 S. Ct. at 1909-10 (citations and internal quotation marks omitted)). Noting that a trust has a separate legal existence for the purpose of income taxes pursuant to *Anderson v. Wilson*, 289 U.S. 20, 27, 53 S. Ct. 417, 420 (1933), *Kaestner 1992 Family Tr.*, ___ N.C. App. at ___, 789 S.E.2d at 650, the Court of Appeals held that the connection between North Carolina and the trust based solely on the residence of the beneficiaries was insufficient to satisfy due process requirements, *id.* at ___, 789 S.E.2d at 651. Consequently, the Court of Appeals affirmed the Business Court's order granting summary judgment for plaintiff. *Id.* at _, 789 S.E.2d at 651. The Court of Appeals chose not to address whether taxation of plaintiff also violated the Commerce Clause. *Id.* at ___, 789 S.E.2d at 651.

On appeal to this Court from the decision of the Court of Appeals, defendant continues to argue that plaintiff had minimum contacts with the State of North Carolina sufficient to satisfy due process

based on the presence of the beneficiaries in the state. Defendant also argues that plaintiff had sufficient minimum contacts with North Carolina through certain acts of the trustee whereby plaintiff benefitted from "the ordered society maintained by taxation in North Carolina." We disagree.

"Our standard of review of an appeal from summary judgment is de novo." *In re Will of Jones*, 362 N.C. 569, 573, 669 S.E.2d 572, 576 (2008) (citing *Forbis v. Neal*, 361 N.C. 519, 523-24, 649 S.E.2d 382, 385 (2007)). "Under the *de novo* standard of review, the [Court] 'consider[s] the matter anew[ ] and freely [substitutes] its own judgment for' [that of the lower court]." *Midrex Techs., Inc. v. N.C. Dep't of Revenue*, 369 N.C. 250, 257, 794 S.E.2d 785, 791 (2016) (first and fifth alterations in original) (quoting *N.C. Dep't of Env't & Nat. Res. v. Carroll*, 358 N.C. 649, 660, 599 S.E.2d 888, 895 (2004) (second and third alterations in original)). On a motion for summary judgment, "[t]he judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to a judgment as a matter of law." N.C.G.S. § 1A-1, Rule 56(c) (2017).

The relevant provision of section 105-160.2 has remained substantively unchanged since the tax years at issue and states that income tax on an estate or trust "is computed on the amount of the taxable income of the estate or trust that is for the benefit of a resident of this State." *Id.* § 105-160.2 (2017). In its complaint and motion for summary judgment, plaintiff maintained that this section is both unconstitutional on its face and as applied to

plaintiff. We presume "that any act passed by the legislature is constitutional, and [we] will not strike it down if [it] can be upheld on any reasonable ground." *State v. Bryant*, 359 N.C. 554, 564, 614 S.E.2d 479, 486 (2005) (quoting *State v. Thompson*, 349 N.C. 483, 491, 508 S.E.2d 277, 281-82 (1998) (second alteration in original)). Consequently, "[a]n individual challenging the facial constitutionality of a legislative act 'must establish that no set of circumstances exists under which the [a]ct would be valid.' " *Thompson*, 349 N.C. at 491, 508 S.E.2d at 282 (second alteration in original) (quoting *United States v. Salerno*, 481 U.S. 739, 745, 107 S. Ct. 2095, 2100 (1987)). Given this exacting standard and that the allegations and evidence appear relevant solely to whether defendant unconstitutionally collected income taxes from plaintiff for tax years 2005 through 2008, we consider only whether section 105-160.2 is unconstitutional as applied to plaintiff to collect the taxes at issue.

In considering an as-applied challenge to the constitutionality of a statute, we look to whether the statute is constitutional in the limited context of the facts of the case before us. Then, as with any constitutional challenge, "[i]f there is a conflict between a statute and the Constitution, this Court must determine the rights and liabilities or duties of the litigants before it in accordance with the Constitution, because the Constitution is the superior rule of law in that situation." *Adams v. N.C. Dep't of Nat. & Econ. Res.*, 295 N.C. 683, 690, 249 S.E.2d 402, 406 (1978) (quoting *Nicholson v. State Educ. Assistance Auth.*, 275 N.C. 439, 447, 168 S.E.2d 401, 406 (1969)).

The Fourteenth Amendment directs that no State shall "deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend XIV. Similarly, our state constitution declares that "[n]o person shall be . . . in any manner deprived of his life, liberty, or property, but by the law of the land." N.C. Const. art. I, § 19. Indeed, we have determined that "[t]he term 'law of the land' as used in Article I, Section 19, of the Constitution of North Carolina, is synonymous with 'due process of law' as used in the Fourteenth Amendment to the Federal Constitution." *Rhyne v. K-Mart Corp.*, 358 N.C. 160, 180, 594 S.E.2d 1, 15 (2004) (quoting *In re Moore*, 289 N.C. 95, 98, 221 S.E.2d 307, 309 (1976)). Accordingly, our analysis of plaintiff's due process challenge below also applies to plaintiff's state constitutional claim.

When applied to taxation, "[t]he Due Process Clause 'requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.' " *Quill*, 504 U.S. at 306, 112 S. Ct. at 1909 (quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45, 74 S. Ct. 535, 539 (1954)). Due process also requires that "the 'income attributed to the State for tax purposes must be rationally related to values connected with the taxing State,' " *id.* at 306, 112 S. Ct. at 1909-10 (internal quotation marks omitted) (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273, 98 S. Ct. 2340, 2344 (1978)); however, in this case we are concerned only with the first requirement. This "minimum connection," which is more commonly referred to as "minimum contacts," *see id.* at 307, 112 S. Ct. at 1910 (citing *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316, 66 S. Ct. 154, 158

(1945)), exists when the taxed entity "purposefully avails itself of the benefits of an economic market" in the taxing state "even if it has no physical presence in the State," *id.* at 307, 112 S. Ct. at 1910 (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476, 105 S. Ct. 2174, 2184 (1985)). The Court in *Quill Corporation* therefore declared: "[T]o the extent that our decisions have indicated that the Due Process Clause requires physical presence in a State" for imposition and collection of a tax, "we overrule those holdings as superseded by developments in the law of due process." *Id.* at 308, 112 S. Ct. at 1911. Applying that standard, the Court went on to hold that the plaintiff in *Quill Corporation* "purposefully directed its activities at North Dakota residents, that the magnitude of those contacts [was] more than sufficient for due process purposes, and that the use tax [was] related to the benefits Quill receive[d] from access to the State," *id.* at 308, 112 S. Ct. at 1911, when the plaintiff generated revenue of almost $1 million annually from selling office equipment and supplies to approximately 3,000 customers in North Dakota even though all merchandise was delivered from out of state by mail or common carriers, *id.* at 302, 112 S. Ct. at 1907-08.

We have similarly determined that a finding of minimum contacts sufficient to satisfy due process "will vary with the quality and nature of the [party's] activity, but it is essential in each case that there be some act by which the [party] purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." *Skinner v. Preferred Credit*, 361 N.C. 114, 123, 638 S.E.2d 203, 210-11 (2006) (quoting *Chadbourn, Inc. v. Katz*, 285 N.C. 700, 705,

208 S.E.2d 676, 679 (1974)). In light of *Quill Corporation* and our understanding of minimum contacts analysis, we therefore consider defendant's first argument in terms of whether plaintiff can be said to have minimum contacts with North Carolina based on the presence of its beneficiaries in our State.

The Supreme Court has observed that even though a "trust is an abstraction . . . . the law has seen fit to deal with this abstraction for income tax purposes as a separate existence, making its own return under the hand of the fiduciary and claiming and receiving its own appropriate deductions." *Anderson*, 289 U.S. at 27, 53 S. Ct. at 420. The Internal Revenue Code imposes a separate tax on the income of trusts, *see* 26 U.S.C. § 1(e) (2012), implicitly recognizing, at least for tax purposes, that a trust is a separate entity to which income is separately attributed. Any tax on that income is physically paid by the fiduciary or trustee, with the amount of the tax being "computed in the same manner as in the case of an individual." *Id.* § 641(a)-(b). In North Carolina "[t]he taxable income of an estate or trust is the same as taxable income for such an estate or trust under the provisions of the Code." N.C.G.S. § 105-160.2. Neither the Code nor Chapter 105 conflates the income of the trust with the income of a beneficiary.

In *Brooke v. City of Norfolk* the Supreme Court considered whether the City of Norfolk and Commonwealth of Virginia had violated the Due Process Clause by taxing the body of a Maryland trust when none of the property held by the trust had ever been present in Virginia. 277 U.S. 27, 28, 48 S. Ct. 422, 422 (1928). Although the Supreme Court applied presence-focused due process analysis

that has since been supplanted by the minimum contacts test, *see Quill*, 504 U.S. at 308, 112 S. Ct. at 1911, the Court also recognized that a trust and its beneficiary are legally independent entities when it observed that the property held by the trust "is not within the State, does not belong to the [beneficiary] and is not within her possession or control. The assessment is a bare proposition to make the [beneficiary] pay upon an interest to which she is a stranger," *Brooke*, 277 U.S. at 29, 48 S. Ct. at 422.

That plaintiff and its North Carolina beneficiaries have legally separate, taxable existences is critical to the outcome here because a taxed entity's minimum contacts with the taxing state cannot be established by a third party's minimum contacts with the taxing state. *See Walden v. Fiore*, ___ U.S. ___, ___, 134 S. Ct. 1115, 1122 (2014) (stating that "unilateral activity of another party or a third person is not an appropriate consideration when determining whether a defendant has sufficient contacts with a forum State" (quoting *Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 417, 104 S. Ct. 1868, 1873 (1984))); *Hanson v. Denckla*, 357 U.S. 235, 253, 78 S. Ct. 1228, 1239-40 (1958) ("The unilateral activity of those who claim some relationship with a nonresident [party] cannot satisfy the requirement of contact with the forum State."). Here it was plaintiff's beneficiaries, not plaintiff, who reaped the benefits and protections of North Carolina's laws by residing here. Because plaintiff and plaintiff's beneficiaries are separate legal entities, due process was not satisfied solely from the beneficiaries' contacts with North Carolina.

Defendant challenges this conclusion by citing to two decisions in which foreign jurisdictions allegedly reached the opposite result. The Supreme Court of Connecticut held that taxation of an *inter vivos* trust did not violate due process because the beneficiary of the trust was a Connecticut domiciliary. *Chase Manhattan Bank v. Gavin*, 249 Conn. 172, 204, 733 A.2d 782, 802, *cert. denied*, 528 U.S. 965, 120 S. Ct. 401 (1999). Describing the domicile of the beneficiary as the "critical link," the Court in *Gavin* went on to reason that the beneficiary "enjoyed all of the protections and benefits afforded to other domiciliaries. Her right to the eventual receipt and enjoyment of the accumulated income was, and so long as she is such a domiciliary will continue to be, protected by the laws of the state." *Id.* at 204, 733 A.2d at 802. Therefore, the Court concluded in *Gavin*:

> [J]ust as the state may tax the undistributed income of a trust based on the presence of the trustee in the state because it gives the trustee the protection and benefits of its laws; it may tax the same income based on the domicile of the sole noncontingent beneficiary because it gives her the same protections and benefits.

Id. at 205, 733 A.2d at 802 (internal citation omitted). Defendant also cites to a decision of the Supreme Court of California for the similar proposition that a "beneficiary's state of residence may properly tax the trust on income which is payable in the future to the beneficiary, although it is actually retained by the trust, since that state renders to the beneficiary that protection incident to his eventual enjoyment of such accumulated income." *McCulloch v. Franchise Tax Bd.*, 61 Cal. 2d

186, 196, 390 P.2d 412, 419 (1964) (emphasis omitted).

We do not find either *Gavin* or *McCulloch* persuasive in deciding the present case. The Court in *Gavin* erroneously failed to consider that a trust has a legal existence apart from the beneficiary and that, consequently, for taxation to satisfy due process pursuant to *Quill*, the trust itself must have "some definite link, some minimum connection" with the taxing state by "purposefully avail[ing] itself of the benefits of an economic market" in that state. *Quill*, 504 U.S. at 306-07, 112 S. Ct. at 1909-10. Furthermore, both the Court in *Gavin* and defendant, in its arguments before this Court, misconstrue a trust's existence as "a fiduciary relationship with respect to property, subjecting the person by whom the property is held to equitable duties to deal with the property for the benefit of another person," *Wescott v. First & Citizens Nat'l Bank of Elizabeth City*, 227 N.C. 39, 42, 40 S.E.2d 461, 462-63 (1946) (quoting Restatement (First) of Trusts § 2 (Am. Law Inst. 1935)), to mean that any possible benefit received by the beneficiary may be imputed to the trust. That conclusion simply does not follow.

In contrast to *Gavin*, several other jurisdictions have applied reasoning similar to our analysis here in the context of deciding whether taxation of a given trust violated due process. *See Linn v. Dep't of Revenue*, 2013 IL App (4th) 121055, ¶ 33, 2 N.E.3d 1203, 1211 (2013) (applying *Quill* and holding that there was insufficient contact between Illinois and the taxed trust to satisfy due process when the trust, *inter alia*, "had nothing in and sought nothing from Illinois" and conducted all of its business in Texas), *appeal dismissed*, 387 Ill. Dec. 512, 22 N.E.3d 1165

(2014); *Fielding v. Comm'r of Revenue*, File Nos. 8911–R, 8912–R, 8913–R, 8914–R, 2017 WL 2484593, at *19-20 (Minn. T.C. May 31, 2017) (deciding that taxation of an *inter vivos* trust based solely on the in-state domicile of the grantor at the time the trust became irrevocable violated due process); *Residuary Tr. A v. Director, Div. of Taxation*, 27 N.J. Tax 68, 72-73, 78 (2013) (holding that neither the New Jersey domicile of a deceased testator nor the New Jersey business interests of several corporations in which the testamentary trust held stock justified New Jersey's taxation of "undistributed income from sources outside New Jersey" pursuant to the due process minimum contacts standard), *aff'd per curiam*, 28 N.J. Tax 541 (2015); *T. Ryan Legg Irrevocable Tr. v. Testa*, 149 Ohio St. 3d 376, 2016-Ohio-8418, 75 N.E.3d 184, at ¶ 68 (2016) (applying *Quill* and holding that a tax assessment by Ohio against a Delaware trust did not violate due process when the trust was created by an Ohio resident to dispose of his interest in a corporation that "conducted business in significant part in Ohio" and the settlor's "Ohio contacts [were] still material for constitutional purposes"), *cert. denied*, ___ U.S. ___, 138 S. Ct. 222 (2017).

McCulloch, on the other hand, was decided before *Quill Corporation*, and therefore has a limited ability to inform our application of the Court's due process analysis in *Quill*. Moreover, we find *McCulloch* to be factually distinguished from the present case because the taxed entity in that case was both a beneficiary and a trustee of the trust and also resided in the taxing jurisdiction. Indeed, in holding that the taxes at issue did not violate due process, the Court in *McCulloch* particularly relied on the

fact that the trustee was a domiciliary of the taxing jurisdiction. *See McCulloch*, 61 Cal. 2d at 194, 390 P.2d at 418. However, that circumstance is not present in this case.

As an alternative to its argument that due process was satisfied based on the North Carolina residence of the beneficiaries, defendant also presents the theory that taxation satisfied due process here because plaintiff "reached out to North Carolina by purposefully taking on a long-term relationship with the trust's beneficiaries, even though the trustees . . . never entered the state." In support, defendant notes that Bernstein restructured the original trust for Kaestner's benefit, regularly communicated with her about management of plaintiff, and directed a loan to Kaestner from plaintiff's assets—all actions that, according to defendant, indicated that plaintiff would have a continuing relationship with Kaestner while she was in North Carolina.

This argument stems from misapprehension of both the facts and law relevant to this case. The undisputed evidence in the record shows that contact between Bernstein and Kaestner regarding administration of the trust was infrequent—consisting of only two meetings during the tax years in question, both of which occurred in New York. Any connection between plaintiff and North Carolina based on the loan is also irrelevant given that the loan was issued in January 2009, after the tax years at issue. Additionally, the United States Supreme Court has directed that " 'minimum contacts' analysis looks to the defendant's contacts with the forum State itself, not the defendant's contacts with persons who reside there." *Walden*, ___ U.S. at ___, 134 S. Ct. at

1122 (citations omitted). As we have already stated, for due process purposes plaintiff, as a separate legal entity in the context of taxation, would have needed to purposefully avail *itself* of the benefits and protections offered by the State. *See Quill*, 504 U.S. at 306-07, 112 S. Ct. at 1909-10. Mere contact with a North Carolina beneficiary does not suffice.

For taxation of a foreign trust to satisfy the due process guarantee of the Fourteenth Amendment and the similar pledge in Article I, Section 19 of our state constitution, the trust must have some minimum contacts with the State of North Carolina such that the trust enjoys the benefits and protections of the State. When, as here, the income of a foreign trust is subject to taxation solely based on its beneficiaries' availing themselves of the benefits of our economy and the protections afforded by our laws, those guarantees are violated. Therefore, we hold that N.C.G.S. § 105-160.2 is unconstitutional as applied to collect income taxes from plaintiff for tax years 2005 through 2008. Accordingly, we affirm the decision of the Court of Appeals that affirmed the Business Court's order granting summary judgment for plaintiff and directed that defendant refund to plaintiff any taxes paid by plaintiff pursuant to section 105-160.2 for tax years 2005 through 2008.

AFFIRMED.

Justice ERVIN dissenting.

As the majority correctly indicates, the proper resolution of this case hinges upon the extent, if any, to which the taxpayer had sufficient minimum contacts with North Carolina to satisfy federal due process requirements. Although we are required to

make what I believe to be a close call in this case, I feel compelled to conclude, after careful scrutiny of the record in light of the applicable relevant legal standard, that taxpayer "purposefully avail[ed] itself of the benefits of an economic market" in North Carolina despite having "no physical presence in the State." *Quill Corp. v. North Dakota*, 504 U.S. 298, 307, 112 S. Ct. 1904, 1910, 119 L. Ed. 2d 91, 102-03 (1992) (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476, 105 S. Ct. 2174, 2184, 85 L. Ed. 2d 528, 543 (1985)). As a result, I respectfully dissent from my colleagues' decision.

According to the undisputed facts contained in the record as identified by the trial court, Joseph Lee Rice, III, established the Rice Family 1992 Trust for the benefit of his children in 1992. The Family Trust was created in New York, with the trust instrument providing that the Family Trust was to be governed by New York law. In 2005, David Bernstein, a resident of Connecticut, was appointed trustee of the Family Trust and continued to act in that capacity throughout the time period at issue in this case. In 2006, Mr. Bernstein, physically divided the Family Trust into three trusts, one of which, plaintiff Kimberly Rice Kaestner 1992 Family Trust, was intended to benefit Kimberly Rice Kaestner and her three children, "all of whom were residents and domiciliaries of North Carolina in the tax years at issue." Mr. Bernstein served as the trustee of the Kaestner Trust following the division of the Family Trust into its three constituent parts.

Throughout the entire interval from 2005 through 2008, which are the tax years at issue in this case, the documents related to the Kaestner Trust were kept in New York, while the custodian of

the Kaestner Trust's assets was located in Boston, Massachusetts. No distributions were made to any beneficiary of the Kaestner Trust during the 2005 through 2008 tax years. During the period from 2005 through 2008, Mr. Bernstein communicated with Ms. Kaestner regarding the Kaestner Trust and provided her with accountings relating to the Kaestner Trust covering the periods from 22 December 2005 through 31 December 2006 and 23 June 2006 through 8 October 2009. In addition, Mr. Bernstein and the law firm with which he was affiliated provided Ms. Kaestner with legal advice regarding matters relating to the Kaestner Trust.

As the entire Court appears to agree, the resolution of this case hinges upon a proper understanding of the decision of the United States Supreme Court in *Quill*, which involved a Delaware corporation that sold office equipment and had physical offices and warehouses in Illinois, California, and Georgia. *Quill*, 504 U.S. at 302, 112 S. Ct. at 1907, 119 L. Ed. at 100. Quill solicited business by using catalogs, flyers, and telephone calls and placing advertisements in national periodicals. *Id.* at 302, 112 S. Ct. at 1907, 119 L. Ed. at 100. As a result of its business activities, Quill had about 3,000 customers and made $1 million in sales in North Dakota during the relevant period. *Id.* at 302, 112 S. Ct. at 1908, 119 L. Ed. at 100. A North Dakota statute provided that retailers, including mail-order companies, were subject to a use tax "even if they maintain no property or personnel in North Dakota." *Id.* at 303, 112 S. Ct. at 1908, 119 L. Ed. at 100. The State argued that, despite Quill's lack of a physical presence within North Dakota, the State "had created 'an economic climate that fosters

demand for' Quill's products, maintained a legal infrastructure that protected that market, and disposed of 24 tons of catalogs and flyers mailed by Quill into the State every year." *Id.* at 304, 112 S. Ct. at 1908-09, 119 L. Ed. at 101.

According to the United States Supreme Court, "[t]he Due Process Clause 'requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax' and that the 'income attributed to the State for tax purposes must be rationally related to values connected with the taxing State.' "[1] *Id.* at 306, 112 S. Ct. at 1909-10, 119 L. Ed. 2d at 102 (first quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45, 74 S. Ct. 535, 539, 98 L. Ed. 744 (1954); then quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273, 98 S. Ct. 2340, 2344, 57 L. Ed. 2d 197 (1978)). As the United States Supreme Court noted, it has "abandoned more formalistic tests that focused on [an entity's] 'presence' within a State in favor of a more flexible inquiry into . . . [an entity's] contacts with the forum." *Id.* at 307, 112 S. Ct. at 1910, 119 L. Ed. 2d at 102 (citing, *inter alia*, *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 66 S. Ct. 154, 90 L. Ed. 95 (1945)). "Applying these principles, we have held that if a foreign [entity] purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's" collection of taxes "even if it has no physical presence in the State." *Id.* at 307, 112 S. Ct. at 1910, 119 L. Ed. 2d at 103 (citing *Burger King Corp.*, 471 U.S. 462, 105 S. Ct. 2174, 85 L. Ed. 2d 528). As a result, given that

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[1] The extent to which the second prong of the due process analysis has been satisfied does not appear to be before us in this case at this time.

Quill had "purposefully directed its activities at North Dakota residents," its contacts with North Dakota were "more than sufficient for due process purposes." *Id.* at 308, 112 S. Ct. at 1911, 119 L. Ed. 2d at 104.

The parties have spent considerable time and effort debating the extent, if any, to which the fact that the beneficiaries of the Kaestner Trust resided in North Carolina during the relevant tax years has any bearing on the required due process analysis. In reaching the conclusion that the residence of the beneficiaries has no bearing upon the proper resolution of this case, my colleagues have deemed *Chase Manhattan Bank v. Gavin*, 249 Conn. 172, 733 A.2d 782, *cert. denied*, 528 U.S. 965, 120 S. Ct. 401, 145 L. Ed. 2d 312 (1999), and *McCulloch v. Franchise Tax Board*, 61 Cal. 2d 186, 390 P.2d 412 (1964), to be essentially irrelevant. I am not inclined to completely disregard either of those decisions, which, to the best of my knowledge, appear to be the only cases decided by state courts of last resort to address the question that is before us in this case, while recognizing that there are distinguishing features which may serve to render them somewhat less persuasive than they might otherwise be.

Admittedly, the assertion of taxing authority over the inter vivos trust at issue in *Gavin* arose from a situation in which "the settlor of the trust was a Connecticut domiciliary when the trust was established and the beneficiary is a Connecticut domiciliary." *Gavin*, 249 Conn. at 183, 733 A.2d at 790. However, in upholding the taxability of the undistributed income held in an inter vivos trust, the Connecticut Supreme Court specifically stated that, "just as the state may tax the undistributed

income of a trust based on the presence of the trustee in the state because it gives the trustee the protection and benefits of its laws," "it may tax the same income based on the domicile of the sole noncontingent beneficiary because it gives her the same protections and benefits." *Id.* at 205, 733 A.2d at 802. As a result, the Connecticut Supreme Court's decision with respect to the taxability of the undistributed income held in the inter vivos trust appears to me to hinge upon the residence of the beneficiary rather than the fact that the settlor had been a resident of Connecticut at the time that the inter vivos trust had been created.

I am loath to completely disregard *McCulloch* for similar reasons. Although the beneficiary of the trust at issue in *McCulloch* also served as one of the trustees, the California Supreme Court's analysis in that case clearly relies upon the status of the person in question as a beneficiary rather than upon his status as a trustee, with this fact being evidenced by the California Supreme Court's statement that "the beneficiary's state of residence may properly tax the trust on income which is payable in the future to the beneficiary, although it is actually retained by the trust, since that state renders to the beneficiary that protection incident to his eventual enjoyment of such accumulated income." *McCulloch*, 61 Cal. 2d at 196, 390 P.2d at 419 (emphasis omitted). Similarly, while *McCulloch* antedates *Quill* and *Burger King*, the logic utilized by the California Supreme Court appears to me to rest upon the same considerations that underlie the United States Supreme Court's modern due process jurisprudence. For example, the California Supreme Court states that "[t]he tax imposed by California upon the beneficiary is

constitutionally supported by a sufficient connection with, and protection afforded to, plaintiff as such beneficiary." *Id.* at 196, 390 P.2d at 419. As a result, I am unable to agree with my colleagues' determination that neither *Gavin* nor *McCulloch* has any bearing upon the proper resolution of this case and am inclined to be persuaded by their logic to believe that, while not dispositive, the presence of the beneficiaries of the Kaestner Trust in North Carolina has some bearing on the proper performance of the required due process analysis.

I also cannot concur in the argument adopted by the Court of Appeals to the effect that the United States Supreme Court has already made our decision for us in *Brooke v. City of Norfolk*, 277 U.S. 27, 48 S. Ct. 422, 72 L. Ed. 767 (1928). Although *Brooke* has not been overruled, it antedates *Quill* and *Burger King* and rests upon the sort of formalistic, presence-focused approach that the United States Supreme Court rejected in those cases in favor of a less rigid "minimum connections" approach. *See Quill*, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91; *Burger King*, 471 U.S. 462, 105 S. Ct. 2174, 85 L. Ed. 2d 528. In addition, *Brooke* involved an attempt by one state to tax a trust corpus held in another state, which is a very different undertaking than an attempt to tax the undistributed income of a non-North Carolina trust that is held for the benefit of a North Carolina resident.[2] The same logic renders the

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[2] Admittedly, this Court has not adopted the Court of Appeals' treatment of *Brooke* as dispositive in its opinion. Instead, the Court simply cites *Brooke* for the unexceptionable proposition that "a trust and its beneficiary are legally independent entities." For the reasons set forth in the text of this dissenting opinion, I believe that a proper due process analysis focused

Kaestner Trust's reliance upon the decision of the United States Supreme Court in *Safe Deposit & Trust Co. of Baltimore v. Commonwealth of Virginia*, 280 U.S. 83, 50 S. Ct. 59, 74 L. Ed. 180 (1929), which involved an attempt to tax the corpus, rather than the undistributed income, of a non-jurisdictional trust based upon the existence of a resident beneficiary that the Court rejected on the basis of a pre-*Quill* method of analysis, unpersuasive. As a result, neither of these cases supports, much less compels, a decision in the Kaestner Trust's favor. Instead, my review of the decisions cited by both parties compels me to conclude that the only way to properly resolve this case involves reliance upon a very fact-specific analysis of the extent, if any, to which the Kaestner Trust "purposefully avail[ed] itself of the benefits of an economic market in the forum State," *see Quill*, 504 U.S. at 307, 112 S. Ct. at 1910, 119 L. Ed. 2d at 103, with this analysis deeming the presence of the beneficiary in North Carolina to be relevant, but not dispositive.

As the Supreme Court explained in *Burger King*,

> it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are 'purposefully directed' toward residents of

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upon the activities of the Kaestner Trust in light of Ms. Kaestner's residence suffices to establish sufficient "minimum contacts" to support the Department of Revenue's attempt to tax the undistributed income applicable to Ms. Kaestner.

> another State, we have consistently rejected the notion that an absence of physical contact can defeat personal jurisdiction there.

471 U.S. at 476, 105 S. Ct. at 2184, 85 L. Ed. 2d at 544 (citations omitted). Although the assets contained in the Kaestner Trust were held in Boston, and the relevant documents were held in New York and although the trustee worked in New York and resided in Connecticut during the tax years at issue in this case, "business [was] transacted . . . by mail and wire communications across state lines," including those of North Carolina. *See id.* at 476, 105 S. Ct. at 2184, 85 L. Ed. 2d at 544. Among other things, Ms. Kaestner was known to be a resident of North Carolina at the time that the Kaestner Trust was created for her benefit. In addition, the trustee transmitted information to Ms. Kaestner, provided advice to Ms. Kaestner, and communicated with Ms. Kaestner in other ways with full knowledge of the fact that she resided in North Carolina. The Kaestner Trust could not have successfully carried out these functions in the absence of the benefits that North Carolina provided to Ms. Kaestner during the time that she lived here. As a result, I am unable to conclude, given the applicable standard of review, that the Kaestner Trust lacked sufficient contacts with North Carolina to permit the State to tax the undistributed income held by the Kaestner Trust for Ms. Kaestner's benefit. Therefore, I see no due process violation. As a result, for all of these reasons, I respectfully dissent from my colleagues' decision to affirm the Court of Appeals' decision.

[ENTERED JULY 5, 2016]

IN THE COURT OF APPEALS OF
NORTH CAROLINA

No. COA15-896

Filed: 5 July 2016

Wake County, No. 12 CVS 8740

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST, Plaintiff,

v.

NORTH CAROLINA DEPARTMENT
OF REVENUE, Defendant.

Appeal by defendant from order entered 23 April 2015 by Judge Gregory P. McGuire in Wake County Superior Court. Heard in the Court of Appeals 23 February 2016.

Attorney General Roy Cooper, by Assistant Attorney General Peggy S. Vincent, for the State.

Moore & Van Allen, PLLC, by Thomas D. Myrick, Neil T. Bloomfield and Kara N. Bitar, for plaintiff-appellee.

BRYANT, Judge.

Where North Carolina did not demonstrate the minimum contacts necessary to satisfy the principles of due process required to tax an out-of-state trust, we affirm the lower court's grant of summary judgment in favor of the trust and uphold the order directing the Department of Revenue to refund taxes and penalties paid by the trust.

On 21 June 2012, representatives of plaintiff The Kimberley Rice Kaestner 1992 Family Trust (the Trust) filed a complaint against the North Carolina Department of Revenue (the Department) after the Department denied a request to refund taxes the Trust paid during tax years 2005 through 2008. The claims brought forth alleged that taxes imposed upon the Trust pursuant to N.C. Gen. Stat. § 105-160.2 were imposed in violation of due process, the Commerce Clause, and the North Carolina Constitution. Pursuant to section 105-160.2, taxes are "computed on the amount of taxable income of the estate or trust that is for the benefit of a resident of this State[.]"

In 1992, an *inter vivos* trust (original trust) was established by settlor Joseph Lee Rice III, with William B. Matteson as trustee. The situs, or location, of the original trust was New York. The primary beneficiaries of the original trust were the settlor's descendants (none of whom lived in North Carolina at the time of the trust's creation). In 2002, the original trust was divided into three separate trusts: one for each of the settlor's children (Kimberley Rice Kaestner, Daniel Rice, and Lee Rice). At that time in 2002, Kimberley Rice Kaestner, the beneficiary of plaintiff Kimberley Rice Kaestner 1992 Family Trust, was a resident and domiciliary of North Carolina. On 21 December 2005, William B. Matteson resigned as trustee for the three separate trusts. The settlor then appointed a successor trustee, who resided in Connecticut. Tax returns were filed in North Carolina on behalf of the Kimberley Rice Kaestner 1992 Family Trust for tax years ending in 2005, 2006, 2007, and 2008 for income accumulated by

the Trust but not distributed to a North Carolina beneficiary. In 2009, representatives of the Trust filed a claim for a refund of taxes paid to the Department amounting to $1,303,172.00, for tax years 2005, 2006, 2007, and 2008. The claim was denied. Trust representatives commenced a contested case action in the Office of Administrative Hearings (OAH). However, the OAH dismissed the contested case for lack of jurisdiction: the sole issue was the constitutionality of the enabling statute, G.S. § 105-160.2. The current action commenced in Wake County Superior Court and, thereafter, was designated as a mandatory complex business case.

On 11 February 2013, the Honorable John R. Jolly, Jr., Chief Special Superior Court Judge for Complex Business Cases, entered an order ruling on a motion to dismiss filed by the Department.[1] Based on the Court's order, the Department asserted Rules 12(b)(1), (2), and (6) as a basis for dismissal of the constitutional claims and the injunctive relief. Judge Jolly found that "[N.C. Gen. Stat. §] 105-241.19 set out exclusive remedies for disputing the denial of a requested refund and expressly prohibit[ed] actions for injunctive relief to prevent the collection of a tax." Judge Jolly granted the Department's motion to dismiss the Trust's claim for injunctive relief which sought a refund of all taxes paid. However, Judge Jolly denied the Department's motion to dismiss the Trust's constitutional claims, concluding "there is at least a colorable argument that North Carolina's

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[1] The Department's motion to dismiss was not made a part of the record on appeal.

imposition of a tax on a foreign trust based solely on the presence of a beneficiary in the state does not conform with the Due Process Clause, the Commerce Clause or Section 19 [of Article I of the North Carolina Constitution]."

On 8 July 2014, the Trust moved for summary judgment, alleging there were no genuine issues of material fact: the Trust had paid the State of North Carolina over $1.3 million in taxes for tax years 2005 through 2008; the Trust was established by a non-resident settlor, governed by laws outside of North Carolina, operated by a non-resident trustee, and did not make any distributions to a beneficiary residing in North Carolina during the pertinent period. The Trust requested that the court declare General Statutes, section 105-160.2 unconstitutional and order a refund of all taxes and penalties paid by the Trust.

The Department also filed a motion for summary judgment. In it, the Department acknowledged that all of the Trust assets were intangibles, and that during the pertinent years, the Trust beneficiaries received no distributions from the Trust. However, quoting a case from the State of Connecticut, *Chase Manhattan Bank v. Gavin*, 249 Conn. 172, 204–05, 733 A.2d 782, 802 (1999), the Department stated:

> [J]ust as the state may tax the undistributed income of a trust based on the presence of the trustee in the state because it gives the trustee the protection and benefits of its laws; *it may tax the same income based on the domicile of the sole*

> *noncontingent beneficiary because it gives her the same protections and benefits.*

(emphasis added).

A summary judgment hearing was held in Wake County Superior Court before the Honorable Gregory P. McGuire, Special Superior Court Judge for Complex Business Cases. In an order entered 23 April 2015, Judge McGuire granted the motion for summary judgment filed on behalf of the Trust and denied the Department's motion. Judge McGuire concluded that N.C. Gen. Stat. § 105-160.2 was unconstitutional as applied and ordered the Department to refund any taxes and penalties paid pursuant to that statute. The Department appeals.

On appeal, the Department argues that the Trust cannot meet its burden to prove it is entitled to a refund of state taxes paid on its accumulated income. Specifically, the Department contends that the Business Court erred when it concluded that taxation of the Trust based on the residence of the beneficiary violated

(A) due process under both the federal and state constitutions, as well as (B) the Commerce Clause of the federal constitution. We disagree.

Standard of Review

> When assessing a challenge to the constitutionality of legislation, this Court's duty is to determine whether the General Assembly has complied with the constitution. . . . In performing our task, we begin with a presumption that the laws duly

> enacted by the General Assembly are valid. *Baker v. Martin*, 330 N.C. 331, 334, 410 S.E.2d 887, 889 (1991). North Carolina courts have the authority and responsibility to declare a law unconstitutional, but only when the violation is plain and clear. *State ex rel. Martin v. Preston*, 325 N.C. 438, 449, 385 S.E.2d 473, 478 (1989). Stated differently, a law will be declared invalid only if its unconstitutionality is demonstrated beyond reasonable doubt. *Baker*, 330 N.C. at 334–35, 410 S.E.2d at 889.

Hart v. State, 368 N.C. 122, 126, 774 S.E.2d 281, 284 (2015).

Due Process

The Department contends that the trial court erred when it concluded that taxation of the Trust based solely on the residence of the beneficiaries violated due process under both the federal and state constitutions.

"The Fourteenth Amendment to the United States Constitution provides that '[n]o State shall . . . deprive any person of life, liberty, or property, without due process of law[.]' U.S. Const. amend. XIV." *Johnston v. State*, 224 N.C. App. 282, 304, 735 S.E.2d 859, 875 (2012) (alteration in original), *writ allowed, review on additional issues denied*, 366 N.C. 562, 738 S.E.2d 360, *aff'd*, 367 N.C. 164, 749 S.E.2d 278 (2013). "No person shall be . . . in any manner deprived of his life, liberty, or property, but by the law of the land." N.C. Const. art. I, § 19. " 'The term "law of the land" as used in Article I, Section 19, of the

Constitution of North Carolina, is synonymous with "due process of law" as used in the Fourteenth Amendment to the Federal Constitution.' " *Rhyne v. K-Mart Corp.*, 358 N.C. 160, 180, 594 S.E.2d 1, 15 (2004) (quoting *In re Moore*, 289 N.C. 95, 98, 221 S.E.2d 307, 309 (1976)). "For purposes of taxation, 'the requirements of . . . "due process" are, for all practical purposes, the same under both the State and Federal Constitutions.' " *In re appeal of Blue Ridge Hous. of Bakersville LLC*, 226 N.C. App. 42, 58, 738 S.E.2d 802, 813 (2013) (citation omitted) (quoting *Leonard v. Maxwell*, 216 N.C. 89, 93, 3 S.E.2d 316, 320 (1939)).

> In analyzing federal constitutional questions, we look to decisions of the United States Supreme Court. We also look for guidance to the decisions of the North Carolina Supreme Court construing federal constitutional and State constitutional provisions, and we are bound by those interpretations. *State v. Elliott*, 360 N.C. 400, 421, 628 S.E.2d 735, 749, (2006) ("The Supreme Court of the United States is the final authority on federal constitutional questions.")[.] We are also bound by prior decisions of this Court construing those provisions, which are not inconsistent with the holdings of the United States Supreme Court and the North Carolina Supreme Court. *In the Matter of Appeal from Civil Penalty*, 324 N.C. 373, 379 S.E.2d 30 (1989).

Johnston, 224 N.C. App. at 288, 735 S.E.2d at 865.

> The Commerce Clause and the Due Process Clause impose distinct but parallel limitations on a State's power to tax out-of-state activities. See *Quill Corp. v. North Dakota*, 504 U.S. 298, 305–306, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992). . . . The "broad inquiry" subsumed in both constitutional requirements is whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state—that is, whether the state has given anything for which it can ask return.

MeadWestvaco Corp. ex rel. Mead Corp. v. Ill. Dep't of Revenue, 553 U.S. 16, 24–25, 170 L. Ed. 2d 404, 412 (2008) (citations and quotations omitted). "The Due Process Clause requires [(1)] some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax, and [(2)] that the income attributed to the State for tax purposes must be rationally related to values connected with the taxing State." *Quill Corp. v. N. Dakota*, 504 U.S. 298, 306, 119 L. Ed. 2d 91, 102 (1992).

Minimum Contacts

As to the question of whether there exists some minimum connection between a state and the . . . property . . . it seeks to tax, *see id.*, "[our Supreme Court has] framed the relevant inquiry as whether a [party] had minimum contacts with the jurisdiction 'such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice.' " *Id.* at 307, 119 L. Ed. 2d at

103 (quoting *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316, 90 L. Ed. 95, 102 (1945)).

> Application of the "minimum contacts" rule will vary with the quality and nature of the [party's] activity, but it is essential in each case that there be some act by which the [party] purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws.

Skinner v. Preferred Credit, 361 N.C. 114, 123, 638 S.E.2d 203, 210–11 (2006) (citation and some quotation marks omitted).

On this point, we note that Judge McGuire made the following unchallenged findings of fact:

> 23. [N]othing in the record indicates, and [the Department] does not argue, that [the Trust] maintained any physical presence in North Carolina during the tax years at issue. The undisputed evidence in this matter shows that [the Trust] never held real property located in North Carolina, and never invested directly in any North Carolina based investments. . . . The record also indicates that no trust records were kept or created in North Carolina, or that the trust could be, in any other manner, said to have a physical presence in the State. Moreover, because the trustee's usual place of business where trust records were kept was outside the State, it is clear from the record that [the Trust's] principal place of administration was not North Carolina.

. . .

> 26. [The Department] concedes that the only "connection between the [Plaintiff] trust and North Carolina in the case at hand is the residence of the beneficiaries."

The Department supports its argument that the residence of the beneficiaries is sufficient to satisfy the minimum contacts criteria of the Due Process Clause by citing to state court opinions from Connecticut and California: *Chase Manhattan Bank v. Gavin*, 249 Conn. 172, 733 A.2d 782 (1999), and *McCulloch v. Franchise Tax Bd.*, 61 Cal. 2d 186, 390 P.2d 412 (1964).

In both *Gavin* and *McCulloch*, the state appellate court noted that the United States Supreme Court had previously upheld the taxation of trust income based on the domicile of the *trustee*, citing *Greenough v. Tax Assessors*, 331 U.S. 486, 91 L. Ed. 1621 (1947). And the *Gavin* and *McCulloch* courts reasoned that similar to the benefits and protections provided by a state to a trustee, the state of the beneficiary's domicile provided benefits and protections sufficient to satisfy the minimum contacts criteria of due process for taxation of the trust. *See Gavin*, 249 Conn. at 204–05, 733 A.2d at 802 ("[J]ust as a state may tax all of the present income of a domiciliary, . . . a state may . . . tax the income of an inter vivos trust that is accumulated for the ultimate benefit of a noncontingent domiciliary, and that is subject to her ultimate power of disposition."); *McCulloch*, 61 Cal. 2d at 196, 390 P.2d at 419 ("[T]he beneficiary's state of residence may properly tax the *trust* on income which is payable in the future to

the beneficiary, although it is actually retained by the trust, since that state renders to the beneficiary that protection incident to his eventual enjoyment of such accumulated income."). On this basis, the Department contends that its taxation of the Trust, predicated solely on the residency of Kimberley Kaestner in North Carolina did not violate due process.

Representatives of the Trust, on the other hand, assert that the Department's contention that a beneficiary's domicile alone is sufficient to satisfy the minimum contacts requirement of the Due Process Clause and allow the state to tax a non-resident trust conflates what the law recognizes as separate legal entities—the trust and the beneficiary. "[W]e do not forget that the trust is an abstraction, . . . [and] the law has seen fit to deal with this abstraction for income tax purposes as a separate existence, making its own return under the hand of the fiduciary and claiming and receiving its own appropriate deductions." *Anderson v. Wilson*, 289 U.S. 20, 27, 77 L. Ed. 1004, 1010 (1933). In other words, for income tax purposes the trust has a separate existence. *Id.*

In support of their position, the Trust representatives direct our attention to *Greenough*, 331 U.S. 486, 91 L. Ed. 1621, a United States Supreme Court opinion. *Greenough* upheld a Rhode Island law authorizing the levy of an *ad valorem* tax upon a resident *trustee* based on a proportionate legal interest of a foreign trust, finding no violation of due process. *Greenough* was a decision from which four justices, including the Chief Justice, dissented. We note with particular interest the dissent of Justice Rutledge, who wrote that "if the

beneficiary's residence alone is insufficient to sustain a state's power to tax the corpus of the trust, *cf. Brooke v. Norfolk*, 277 [U.S.] 27, 72 [L. Ed.] 767, 48 [S. Ct.] 422, it would seem that the mere residence of one of a number of trustees hardly would supply a firmer foundation." *Id.* at 503, 91 L. Ed. at 1633 (footnote omitted). After a careful look at *Brooke*, 277 U.S. 27, 72 L. Ed. 767 (1928), we find it to be not only relevant to the instant case, but also controlling.

In *Brooke*, the petitioner—a Virginia resident and trust beneficiary—appealed to the United States Supreme Court after the City of Norfolk and the State of Virginia assessed taxes upon the corpus of a trust created by a Maryland resident. *Id.* at 28, 72 L. Ed. at 767–78. The petitioner contended that the assessment of the taxes was contrary to the Fourteenth Amendment. *Id.* at 28, 72 L. Ed. at 767. The Maryland resident created a testamentary trust and bequeathed to it $80,000.00, naming petitioner as beneficiary. The trustee, Safe Deposit & Trust Company of Baltimore, was directed to pay income from the trust to the petitioner for life. *Id.* at 28, 72 L. Ed. at 768. The Court noted that "[t]he property held in trust has remained in Maryland and no part of it is or ever has been in Virginia." *Id.*

> The petitioner has paid without question a tax upon the income received by her. But the doctrine contended for now is that the petitioner is chargeable as if she owned the whole. . . . But here the property is not within the state, does not belong to the petitioner and is not within her possession or control. The assessment is a bare

> proposition to make the petitioner pay upon an interest to which she is a stranger. This cannot be done. *See Wachovia Bank & T. Co. v. Doughton*, 272 U. S. 567, 575, 71 L. [E]d. 413, 419, 47 Sup. Ct. Rep. 202.

Id. 28–29, 72 L. Ed. at 768.

The strong similarities between the facts in *Brooke* and the instant case cannot be ignored. While the trust in *Brooke* was a testamentary trust and the Trust here an *inter vivos* trust, both were created and governed by laws outside of the state assessing a tax upon the trust. The trustee for both trusts resided outside of the state seeking to tax the trust. The beneficiary of the trust who resided within the taxing state had no control over the trust during the period for which the tax was assessed. And, the trusts did not own property in the taxing state.[2] In the instant case, the Trust's beneficiary did not receive a taxable distribution from the Trust during the years for which the Department has assessed a tax.

In determining that the authority as set forth by the United States Supreme Court in *Brooke* controls the analysis and outcome of this issue, we must decline the Department's request that we accept as persuasive the authority as set out by the California Supreme Court, *McCulloch*, 61 Cal. 2d 186, 390 P.2d 412, or the Connecticut Supreme

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[2] In *Brooke*, it was duly noted that the petitioner paid tax assessments in Virginia on the distributions made to her as a resident of the state; however, she had no duty under the law (or constitution) to pay taxes on the *corpus* of the trust which existed in another state and over which she had no control. *See* 277 U.S. at 28–29, 72 L. Ed. at 768.

Court, *Gavin*, 249 Conn. 172, 733 A.2d 782. Thus, because of *Brooke*, we hold that based on the facts of the instant case, the connection between North Carolina and the Trust was insufficient to satisfy the requirements of due process. Therefore, the Department's assessment of an income tax levied pursuant to the authority set out in General Statutes, section 105-160.2 was in violation of the Due Process Clause of the United States Constitution, and the Law of the Land Clause of the North Carolina Constitution. Accordingly, we affirm Judge McGuire's order granting summary judgment for the Trust and directing that the Department refund any and all taxes and penalties paid by the Trust pursuant to section 105-160.2 with interest.

As a consequence, we do not address the Department's contention that the Business Court erred when it concluded taxation of the Trust based on the residence of the beneficiary violated the Commerce Clause of the federal constitution.

AFFIRMED.

Judges STEPHENS and McCULLOUGH concur.

[ENTERED APRIL 23, 2015]

STATE OF NORTH CAROLINA

COUNTY OF WAKE

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COUNTY OF WAKE COURT DIVISION
12 CVS 8740

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST, Plaintiff	)	
v.	)	OPINION AND ORDER ON MOTIONS FOR SUMMARY JUDGMENT
NORTH CAROLINA DEPARTMENT OF REVENUE, Defendant	)	

THIS CAUSE, designated a mandatory complex business case by Order of the Chief Justice of the North Carolina Supreme Court, pursuant to N.C. Gen. Stat. § 7A-45.4(b), and assigned to the undersigned Special Superior Court Judge for Complex Business Cases, comes before the Court, pursuant to Rule 56 of the North Carolina Rules of Civil Procedure ("Rule(s)"), upon Plaintiff The Kimberley Rice Kaestner 1992 Family Trust's ("Plaintiff" or "Trust") Motion for Summary Judgment ("Plaintiff's Motion") and Defendant North Carolina Department of Revenue's ("Defendant") Motion for Summary Judgment ("Defendant's Motion") (together

with Plaintiff's Motion, "Motions"). On February 24, 2015, the Court held a hearing on the Motions.

THE COURT, after reviewing the Motions, briefs in support of and in opposition to the Motions, arguments of counsel, and the evidence and other appropriate matters of record, CONCLUDES that Plaintiff's Motion should be GRANTED and Defendant's Motion should be DENIED for the reasons stated herein.

Moore & Van Allen PLLC by Thomas D. Myrick, Esq., Neil T. Bloomfield, Esq., and Kara N. Bitar, Esq. for Plaintiff The Kimberley Rice Kaestner 1992 Family Trust.

North Carolina Department of Justice by Peggy S. Vincent, Esq. for Defendant North Carolina Department of Revenue.

McGuire, Judge.

Procedural History

1. Plaintiff filed this action on June 30, 2012, seeking a determination that, as it was applied to Plaintiff, North Carolina General Statute § 105-160.2 (hereinafter, references to North Carolina General Statutes will be to "G.S.") violates the Due Process Clause and the Commerce Clause of the United States Constitution and Section 19 of the North Carolina Constitution. Plaintiff seeks a refund of all taxes, penalties, and interest paid by it pursuant to G.S. § 105.160.2 for the tax years 2005 through 2008. In its Complaint, Plaintiff also sought to enjoin Defendant from enforcing any assessments issued pursuant to G.S. § 105-160.2 and from issuing future assessments against Plaintiff based on the same provision.

2. On February 11, 2013, the Court granted, in part, Defendant's Motion to Dismiss pursuant to Rule 12(b)(6). In its Order on Motion to Dismiss, the Court dismissed Plaintiff's claim for injunctive relief, but denied the Motion to Dismiss as to the constitutional challenges to the statute.

3. On July 2, 2014, Plaintiff filed its Motion for Summary Judgment. On September 2, 2014, Defendant filed its Motion for Summary Judgment. Both Motions have been fully briefed and, on February 24, 2015, the Court held a hearing on both Motions.

4. Both Motions seek summary judgment in the parties' respective favors on the constitutionality of G.S. § 105-160.2. Therefore, for the purpose of this Opinion and Order, the Court will address the Motions together.

Factual Background

5. A court does not make findings of fact in ruling upon a motion for summary judgment. However, the court may summarize material facts that do not appear to be at issue and which justify the judgment. *Hyde Ins. Agency, Inc. v. Dixie Leasing Corp.*, 26 N.C. App. 138, 142 (1975). There is very little dispute as to any of the facts in this action, and the dispositive facts are undisputed.

6. In 1992, the Joseph Lee Rice, III Family 1992 Trust ("Family Trust") was created for the benefit of the children of Joseph Lee Rice, III ("Settlor") under a trust agreement between Settlor and the initial trustee, William B. Matteson.[1] In 2005, Matteson resigned as trustee

[1] Bernstein Aff. (July 2, 2014) ¶ 3.

of the Family Trust, and David Bernstein ("Bernstein"), a Connecticut resident and domiciliary, was appointed trustee.[2] Bernstein was the trustee of the Family Trust at all times relevant to this action.

7. The Family Trust was created in New York and is governed by New York Law.[3] At the time the Family Trust was created, Settlor and the initial trustee were residents and domiciliaries of New York.[4] At the time of its creation, no primary or contingent beneficiary was a resident or domiciliary of North Carolina.[5] In 1997, Kimberley Rice Kaestner ("Kaestner"), a daughter of the Settlor and a primary beneficiary of the Family Trust, relocated to North Carolina.[6]

8. On December 30, 2002, by operation of the trust agreement, the Family Trust was divided into separate share trusts for each of the Settlor's three children, including Kaestner. [7] In 2006, Bernstein "physically divided" the share trusts into three trusts.[8] Plaintiff is the separate share trust formed for the benefit of Kaestner.[9] The current beneficiaries of Plaintiff are Kaestner and her three children, all of whom were residents and domiciliaries of North Carolina in the tax years at issue.[10] The contingent remainder beneficiaries

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[2] *Id.* ¶ 13.
[3] *Id.* ¶ 4.
[4] *Id.* ¶ 5.
[5] *Id.*
[6] *Id.* ¶¶ 7-8.
[7] *Id.* ¶ 7.
[8] Bernstein Dep. 6.
[9] Bernstein Aff. ¶ 7.
[10] *Id.* ¶ 10.

of Plaintiff are the Settlor's remaining children, the Settlor's spouse, and the Settlor's sister, none of whom are, or were, residents or domiciliaries of North Carolina.[11]

9. The Family Trust, which includes Plaintiff, is an irrevocable *inter vivos* trust.[12] The terms of the Family Trust provided that when Kaestner turned 40 years of age, the Trustee was to distribute the trust assets to Kaestner. Kaestner turned 40 on June 2, 2009. Prior to turning 40, Ms. Kaestner had conversations with her father and Bernstein as to whether she wished to receive the trust assets at her 40th birthday.[13] Kaestner determined she preferred to extend the Trust.[14] Accordingly, in 2009, prior to Kaestner's 40th birthday, Bernstein transferred the assets of the Trust into a new trust, the KER Family Trust. It is undisputed that the transfer of assets occurred after the tax years at issue in this case, and the KER Family Trust is not a party to this action.

10. During the tax years at issue in this case, the assets held by Plaintiff consisted of various financial investments including equities, mutual funds, and investments in partnerships. The custodian of Plaintiff's assets was located in Boston, Massachusetts. Other documents related to the Trust, including ownership documents of some assets of Plaintiff, financial books and records, and legal records, were all kept in New York.[15]

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[11] *Id.* ¶ 11.
[12] *Id.* ¶ 12.
[13] Kaestner Dep. 8-10.
[14] Kaestner Dep. 9.
[15] Bernstein Aff. ¶ 14.

Additionally, all tax returns and Trust accountings have been prepared in New York.[16]

11. Under the terms of the Trust, the beneficiaries, including Kaestner, had no absolute right to any of the assets or income of the Plaintiff, as the distributions of assets or income are made at the sole discretion of the trustee, Bernstein.[17] Furthermore, under the terms of the Trust, Bernstein had broad authority to manage the property held by the Trust "as if the absolute owner thereof."[18] During the years in question no distributions were made to a beneficiary in North Carolina.[19]

12. Notwithstanding the discretionary nature of the Trust and the broad authority granted to the trustee, it is undisputed that two loans were made from the Trust for the benefit of Kaestner or other beneficiaries. In 2007 or 2008, Plaintiff loaned $250,000.00 directly to Kaestner in order to allow her to pursue an investment in vanilla.[20] In 2008 or 2009, a loan was made from Plaintiff to a related trust, the Special Asset Trust, to enable the Special Asset Trust to make a capital call on a limited partnership interest that it held.[21] Both loans were made at the lowest interest rate

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[16] *Id.*

[17] *Id.* ¶ 16; *see also id.* Ex. A, Art. 1, § 1.2(a).

[18] *Id.* Ex. A., Art. 5, § 5.2(r).

[19] *Id.* ¶ 17.

[20] Bernstein Dep. 48-49.

[21] Bernstein Dep. 47. In 2007, some assets of the Plaintiff were transferred, or decanted, into the newly formed Special Asset Trust. The Special Asset Trust is not the Plaintiff in this action. *Id.* 32.

allowable by the Internal Revenue Service and both loans were ultimately repaid.[22]

13. Bernstein occasionally communicated with Kaestner regarding Plaintiff. Kaestner was provided an accounting of the Trust,[23] and received legal advice regarding the Trust from Bernstein and his firm.[24] Additionally, Bernstein met with Kaestner and her husband in New York to discuss the Trust, whether the Kaestners desired to receive income distributions, and certain investments the Trust held.[25]

14. During the tax years at issue, 2005 to 2008, Defendant taxed Plaintiff on the income accumulated in the Trust during each year, although no income was distributed to a North Carolina beneficiary.[26] Plaintiff seeks refunds totaling in excess of $1.3 million, including $79,634.00 paid for the year 2005; $106,637.00 paid for 2006; $1,099,660.00 paid for 2007; and $17,241.00 paid for 2008.[27] Plaintiff's request for a refund was denied on February 11, 2011.[28] Although Plaintiff's Complaint seeks return of penalties paid on these amounts, no penalties were paid to the State of North Carolina after Plaintiff received a complete waiver of these fees.[29]

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[22] *Id.* at 47-49, 52.
[23] Bernstein Dep. 60.
[24] *Id.* at 56-57.
[25] *Id.* at 64-73.
[26] Bernstein Aff. ¶¶ 19, 21.
[27] *Id.* ¶ 22.
[28] *Id.* ¶ 23.
[29] Koonce Aff. ¶¶ 4-5.

Discussion

15. In this lawsuit, Plaintiff challenges the Department's authority to impose income taxes on the Trust during the years 2005–2008 pursuant to G.S. § 105-160.2. For purposes of context, G.S. § 105-160.2 provides, in pertinent part, as follows:

> The tax imposed by this part applies to the taxable income of estates and trusts as determined under the provisions of the Code . . . . The tax is computed on the amount of the taxable income of the estate or trust that is for the benefit of a resident of this State, or for the benefit of a nonresident to the extent that the income (i) is derived from North Carolina sources and is attributable to the ownership of any interest in real or tangible personal property in this State or (ii) is derived from a business, trade, profession, or occupation carried on in this State . . . . The fiduciary responsible for administering the estate or trust shall pay the tax computed under the provisions of this Part.

16. In actuality, the only part of G.S. § 105-160.2 that is at issue in this action is the clause of the above-quoted language that provides for a trust to pay taxes on income "that is for the benefit of a resident of this State."[30]

17. Plaintiff alleges that Section 105-160.2 is unconstitutional on its face and as applied under the Due Process and Commerce Clauses of the United States Constitution, and a violation of

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[30] Compl. ¶ 2.

Article I, Section 19 of the North Carolina Constitution.[31] "When a constitutional question is properly presented, it is the duty of the court to ascertain and declare the intent of the framers of the Constitution and to reject any legislative act which is in conflict therewith." *Mitchell v. N. C. Indus. Dev. Fin. Auth.*, 273 N.C. 137, 144 (1968); *see also Williams v. Blue Cross Blue Shield*, 357 N.C. 170, 183 (2003) (noting this duty and striking down a local act as unconstitutional).

18."In challenging the constitutionality of a statute, the burden of proof is on the challenger, and the statute must be upheld unless its unconstitutionality clearly, positively, and unmistakably appears beyond a reasonable doubt or it cannot be upheld on any reasonable ground." *Guilford Cnty Bd. of Educ. v. Guilford Cnty Bd. of Elections*, 110 N.C. App. 506, 511 (1993). When questioning the authority in court of the State to exert its taxing power, "only clear and demonstrated usurpation of power will authorize judicial interference with legislative action." *Railway Express Agency, Inc. v. Maxwell*, 199 N.C. 637, 642 (1930) (quoting *Green v. Frazier*, 253 U.S. 233, 239 (1920)). As the Supreme Court of the United States has explained, "[a] state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized

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[31] Compl. ¶¶ 40, 47, and 49.

society." *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 444 (1940).

19. The parties agree that the dispositive facts necessary for the Court to decide this case are not in dispute. The question for determination is whether Defendant has the authority under the United States and North Carolina Constitutions to tax Plaintiff on the undistributed income of the Trust based solely upon the beneficiaries' residence in this State.[32]

Due Process Challenge

20. Plaintiff challenges §105-160.2 under the Due Process Clause of the United States Constitution and the Law of the Land Clause of the North Carolina Constitution. The Fourteenth Amendment to the United States Constitution provides that no state shall "deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend XIV, § 1. Article I, Section 19 of the Constitution of North Carolina guarantees due process rights by providing that no person shall be "in any manner deprived of his life, liberty, or property, but by the law of the land." The North Carolina Supreme Court has noted that "[t]he term 'law of the land' as used in Article I, Section 19, of the Constitution of North Carolina, is synonymous with 'due process of law' as used in the Fourteenth Amendment to the Federal Constitution." *Rhyne v. K-Mart Corp.*, 358 N.C. 160, 180 (2004). Accordingly, these provisions are, "for all practical purposes, the same under both the State and Federal Constitutions." *Leonard v.*

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[32] Def.'s Br. Supp. Mot. Summ. J. 19-20.

Maxwell, 216 N.C. 89, 93 (1939). Under either constitution, "a State's 'exaction of a tax constitutes a deprivation of property' subject to the safeguards of the Due Process Clause." *Delhaize Am., Inc. v. Lay*, 222 N.C. App. 336, 343 (2012) (quoting *McKesson Corp. v. Div. of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 36 (1990)). Accordingly, Plaintiff's due process challenge to the statute under the United States and North Carolina Constitutions may be analyzed together.

21. When a state seeks to impose a tax, the Due Process Clause requires: (1) "some definite link, some minimum connection, between a state and a person, property or transaction it seeks to tax;" and (2) "that the income attributed to the State for tax purposes . . . be rationally related to values connected with the taxing state." *Quill v. North Dakota*, 504 U.S. 298, 306 (1992). Under the first requirement, courts consider whether a taxed entity's "connections with a State are substantial enough to legitimate the State's exercise of power over" it. *Id.* at 312. Where the taxed entity has no physical presence in a state, the entity must "purposefully avail itself of the benefits of an economic market in the forum state." *Id.* at 307. This requirement ensures that the taxed entity is given "fair warning that *its activity* may subject it to the jurisdiction of a foreign sovereign." *Id.* at 308 (emphasis added). Under the second requirement, courts analyze "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state." *J. C. Penney Co.*, 311 U.S. at 444.

22. The focus of the due process inquiry must be on the entity being called upon to pay taxes under

G.S. §105-160.2; here, Plaintiff itself.[33] Accordingly, the Court must scrutinize Plaintiff's contacts with, and relationship to, North Carolina, as well as benefits conferred upon it by North Carolina, to determine the State's authority to tax Plaintiff.

23. Turning to Plaintiff's contacts with the State of North Carolina, nothing in the record indicates, and Defendant does not argue, that Plaintiff maintained any physical presence in North Carolina during the tax years at issue. The undisputed evidence in this matter shows that Plaintiff never held real property located in North Carolina, never owned personal property located in North Carolina, and never invested directly in any North Carolina based investments.[34] The record also indicates that no trust records were kept or created in North Carolina, or that the trust could be, in any other manner, said to have a physical presence in the State. Moreover, because the trustee's usual place of business where trust records were kept was outside the State, it is

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[33] The parties do not dispute that the Plaintiff Trust, and not Kimberly Kaestner or her children, is the taxed entity. *See Anderson v. Wilson*, 289 U.S. 20, 27 (1933) (holding "the law has seen fit to deal with this abstraction [a trust] for income tax purposes as a separate existence").

[34] The Court recognizes that, during the tax years at issue, Plaintiff held investments in entities that, in turn, made investments that may have been related to North Carolina, incurring losses of less than $2.50 in the tax years at issue. However, such an indirect connection is not a sufficient contact to satisfy due process standards. *See Residuary Trust A. v. Director*, 27 N.J. Tax 68, 76-77 (2013) (holding that a trust did not own New Jersey assets simply by investing in an entity that owned New Jersey assets).

clear from the record that Plaintiff's principal place of administration was not North Carolina.[35]

24. Defendant contends, however, that the situs, or residence, of the trust is irrelevant as many of its assets are "stored in the cloud" and therefore do not exist in tangible form.[36] However, the Court notes that other courts have treated the situs of intangible assets such as securities as the physical location of the owner or at which the physical certificates are maintained. *See Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83, 92 (1929) ("Intangible personal property may acquire a taxable situs where permanently located, employed and protected;" and cases cited therein); *Hanson v. Denckla*, 357 U.S. 235, 247 n. 16 (1958). These items being located, held, and protected outside North Carolina, the Court finds Defendant's position unpersuasive.

25. Since Plaintiff has no physical presence in the State, the Court must determine whether Plaintiff has "purposefully availed" itself of the benefits, economic and otherwise, and laws of North Carolina. As noted above, it is the taxed entity that must direct its actions towards the taxing state. Such actions could include "the keeping of tangible or intangible personality within a state," "the use and sale of property," and incorporation in, or permission to conduct business granted by, a state. *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 345

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[35] *See* G.S. § 36C-1-103 (defining the principal place of administration for a trust); *see also* G.S. § 36C-2-203(d) (recognizing a distinction between trusts administered inside and outside North Carolina).

[36] *See* Def.'s Br. Supp. Mot. Summ. J. 7-9.

(1954). More specific to a trust, the maintenance of offices, the ownership of assets, or the transaction of business in a state might provide sufficient minimum connection to tax the trust. *Hanson*, 357 U.S. at 251.

26. Defendant concedes that the only "connection between the [Plaintiff] Trust and North Carolina in the case at hand is the residence of the beneficiaries." [37] Defendant contends, however, that Kaestner and her three children have "made North Carolina their home, residence and domicile" since 1997 and that "all of the income earned by the Trust in the years at issue was for the benefit of Ms. Kaestner and her three children." [38] Defendant argues that because the beneficiaries had an equitable interest in Plaintiff's assets, and could potentially have received future distributions, the Trust should be taxable in North Carolina based on their residence in the State.[39] The Court finds Defendant's position unpersuasive for two reasons.

27. First, Defendant's position conflates the beneficiaries' contact with North Carolina with that of the Trust. As noted above, trusts and their beneficiaries are separate legal entities. *See Anderson*, 289 U.S. at 27 (recognizing that, for income tax purposes, trusts are a "separate existence"). Accordingly, Plaintiff's contacts with North Carolina are relevant here, but not those of its beneficiaries. Nothing in the record indicates that Plaintiff itself ever engaged in the sort of

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[37] *Id.* at 7, 9.
[38] *Id.* at 7.
[39] *Id.* at 9-11.

"purposeful availment" that would subject it to taxation in North Carolina. *See Miller Brothers Co.*, 347 U.S. at 345 (recognizing actions that would constitute sufficient contact to permit taxation by the State of Maryland).

28. Second, Defendant's position ignores the undisputed facts that Kaestner and her children had no control over Plaintiff's assets or ability to generate income from those assets, and had no authority to compel Plaintiff to distribute income earned by the Trust. In North Carolina, the beneficiaries of a trust have no legal interest in the trust's current or future income unless and until they are distributed. *Sabine v. Gill*, 229 N.C. 599, 605 (1948) (trust income "is an intangible which belongs to the trust estate and becomes [the beneficiary's] only by distribution"). Accordingly, the Court concludes that even if the beneficiaries' interest in the Trust's income and assets constitutes an "equitable interest," as Defendant contends, such a remote interest does not provide a sufficient nexus between the Trust and the State of North Carolina such that the latter can tax the income of the former.

29. Defendant also disputes "Plaintiff's unqualified characterization" that the Trustee managed Plaintiff without any consultation with Kaestner.[40] Defendant contends that Kaestner was provided information about the Trust from Bernstein as trustee, received advice concerning the Trust, and even received two loans from the Trust. This contact with the Trustee, Defendant appears to contend, constitutes a contact between

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[40] Def.'s Br. Opp. Pl.'s Mot. Summ. J. 12.

Plaintiff and the State and further demonstrates that Kaestner had some input in, and thus some control over, operations of the Trust.

30. While the record indicates that Kaestner received information concerning the Trust and received one direct loan from the Trust,[41] it remains undisputed that the actual control of Plaintiff remained with the Trustee in his absolute discretion.[42] Moreover, such infrequent contact as reflected in the record,[43] contact driven by the beneficiary and not Plaintiff, cannot, as a matter of law, constitute sufficient contact of Plaintiff with the State such that all of Plaintiff's undistributed income is subject to taxation in North Carolina.

31. Under these circumstances, the Court does not believe that the residency of the beneficiaries in North Carolina, standing alone, can be viewed as the Trust's "purposeful" activity in this State. *Safe Deposit & Trust Co.*, 280 U.S. at 91; *Mercantile-Safe Deposit & Trust Co. v. Murphy*, 203 N.E.2d 490 (N.Y. 1964) ("[T]he imposition of a tax in the State in which the beneficiaries of a trust reside, on securities in the possession of the trustee in another State, to the control or possession of which the beneficiaries have no present right, is in

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[41] In addition to the loan to the Special Asset Trust that, Defendant contends, was for Kaestner's benefit. *See supra*, ¶ 12.

[42] *See* Bernstein Aff. ¶ 16 (noting that the Trustee never consulted with the beneficiaries concerning investment decisions, and that Trustee had, at all relevant times, the sole discretion to make all investment decisions).

[43] *See* Bernstein Dep. 81-84 (describing infrequent, "maybe once a year," meetings with the Kaestners).

violation of the Fourteenth Amendment"). [44] Ultimately, Plaintiff has "clearly, positively, and unmistakably" established that it did not have contacts of a sufficient quality or quantity to be subjected to taxes by the State of North Carolina and to satisfy the requirements of due process.

32. Plaintiff also has established that the tax levied on the Trust fails to satisfy the second requirement of the due process analysis because the income attributed to North Carolina for tax purposes is not rationally related to values connected with North Carolina. *See Quill*, 504 U.S. at 306. Under this prong, courts must analyze "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state." *J. C. Penney*, 311 U.S. at 444. The Supreme Court distilled the analysis even further: "The simple but controlling question is whether the state has given anything for which it can ask return." *Id.* As discussed above, the undisputed evidence shows that Plaintiff, as a taxed entity distinct from its beneficiaries, has not done anything to seek out the protection, opportunities, and benefits conferred by North Carolina, and North Carolina has not provided anything to the Trust for which it can ask return.

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[44] To the extent Defendant contends that Kaestner's or her children's activities in North Carolina constitute the Trust's activities, their activities clearly cannot satisfy the minimum contacts required by due process. *Hanson*, 357 U.S. at 255. ("The unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum state.")

33. Defendant does not expressly address this second requirement of the due process analysis. Instead, Defendant contends that *Quill* did not create a rigid test for determining whether due process standards have been met. Defendant argues that the relevant inquiry is whether the taxed entity "had minimum contacts with the jurisdiction 'such that maintenance of the suit does not offend traditional notions of fair play and substantial justice'" and whether the taxed entity's contacts with the forum made it reasonable for the jurisdiction to impose the tax.[45] Even applying these standards, however, the tax levied against Plaintiff does not meet due process requirements. As discussed above, the entity that is subjected to the taxes still must have sufficient *contacts* with the state that make it fair and reasonable that the state impose the taxes at issue. Again, the only contact that Plaintiff has with North Carolina is the presence in the State of beneficiaries who hold, at most, only equitable interests in the Trust. Not only have the beneficiaries not enjoyed any distribution from the Trust, it is undisputed that Kaestner and her children cannot compel distributions, have no right to control the assets held by Plaintiff and have had no influence over the amount of income generated by Plaintiff. While the presence of Kaestner and her children in North Carolina may provide *some* contact with the State, absent any other contact by Plaintiff, it does not provide the minimum contacts necessary to satisfy the due process requirement of the United States and North Carolina Constitutions.

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[45] Def.'s Reply to Pl.'s Resp. 6.

34. Defendant relies heavily on two decisions from other states, *McCulloch v. Franchise Tax Board*, 390 P.2d 412 (Cal. 1964), and *Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999). In *McCulloch*, a beneficiary residing in California received a terminal distribution in 1951 from a non-resident trust. The distribution included the trust assets and the income earned and accumulated in the trust during the years 1946-1950. *Id.* at 415. California taxed the beneficiary for the income earned by the trust during the five years prior to the distribution and for which the trust had not paid taxes to California. *Id.* The beneficiary challenged the assessment of the tax on the income earned by the trust on due process grounds. The Supreme Court of California held that the tax met due process requirements because it concluded that the beneficiary's "residence [in California] confers the essential 'minimum connection' necessary for due process of law." *Id.* at 419. The Court reasoned that "the beneficiary's state of residence may properly tax the trust on income which is payable in the future to the beneficiary, although it is actually retained by the trust, since that state renders to the beneficiary that protection incident to his eventual enjoyment of the accumulated income." *Id.*

35. As a preliminary matter, the *McCulloch* case has features which distinguish it from this case. In *McCulloch*, the taxed beneficiary was also a trustee of the trust. While not the basis for its holding, the Court explained that "[n]o possible doubt attaches to California's constitutional power to tax plaintiff as a trustee. His secondary role as trustee reinforces the independent basis of taxing plaintiff

as beneficiary." *Id.* at 421. Ms. Kaestner and her children are not trustees of the Trust.

36. In addition, the precise question before the court in *McCulloch* was California's right to tax the beneficiary for the trust's accumulated income upon a distribution, not the direct taxation of the trust itself. *McCulloch*, 390 P.2d. at 414-15, 419, 421. The court stated:

> [T]o hold that California could not levy this tax upon the beneficiary when the trust is distributed to him would expose this state to serious impediments in the collection of its taxes. The purpose of section 18106 of the Revenue and Taxation Code in imposing upon the beneficiary at the time of the trust distribution his personal obligation to pay taxes due, but unpaid, by the trust is to avoid the difficulties which the state might otherwise encounter in attempting to enforce tax collection directly against foreign trustees.

Id. at 420. Here, of course, the tax is not being assessed against Kaestner or her children, and is not being collected upon a distribution.

37. Ultimately, however, this Court simply does not find *McCulloch* persuasive and reaches a different result. The Court concludes that the beneficiary's residence in North Carolina, standing alone, is not a sufficient contact by the Trust with this State to support the imposition of the tax at issue, and that the benefits enjoyed by Ms. Kaestner and her children as residents of North Carolina are not "protection, opportunities, and

benefits" conferred upon the Trust. *J.C. Penney*, 311 U.S. at 444.

38. In *Gavin*, the Supreme Court of Connecticut reached a similar result to *McCulloch*, concluding "just as the state may tax the undistributed income of a trust based on the presence of the trustee in the state because it gives the trustee the protection and benefits of its laws . . . it may tax the same income based on the domicile of the sole non- contingent beneficiary because it gives her the same protections and benefits." *Gavin*, 733 A.2d at 802. [46] Like *McCulloch*, the facts of *Gavin* provide grounds for distinguishing it from this matter. In *Gavin*, the settlor of the trust was also a Connecticut domiciliary when he created the trust and, accordingly, the trust was a Connecticut "resident *inter vivos* trust." *Id.* at 787, 789.[47] In this case, the Settlor of the Trust was a resident of New York, and there is no North Carolina statute making the Kaestner Trust a resident trust of this State.

39. In reaching its conclusion, the court in *Gavin* also stated that it was "not persuaded that . . . *Safe Deposit & Trust Co. v. Virginia* . . . is still good law" because the holding was based, in part, on the potential that the trust could be subjected to "double taxation," that is, taxation in more than one state. *Id.* at 802. First, *Safe Deposit & Trust*

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[46] In *Gavin*, the Court expressly relied upon *McCulloch* as supporting its holding. *Gavin*, 733 A.2d at 803.

[47] Connecticut General Statute § 12-701(a)(4)(D) provided that a resident *inter vivos* trust is "a trust, or portion of a trust, consisting of the property of (i) a person who was a resident of this state at the time the property was transferred to the trust if the trust was then irrevocable."

Co. v. Virginia has not been expressly overruled. Second, a close reading of *Safe Deposit & Trust Co. v. Virginia* demonstrates that the Court considered many of the same factors present in this case in reaching its holding. Central to the analysis in *Safe Deposit & Trust Co.*, the Court noted that, as is the case here, the possessor of the legal title to the securities held in trust in that case resided outside of the state imposing the tax on those assets, and the beneficiaries had no "present right to their enjoyment or power to remove them." *Safe Deposit & Trust Co.*, 280 U.S. at 92. Accordingly, the Court does not agree that *Safe Deposit & Trust Co.* is no longer "good law," as characterized by the *Gavin* court, but remains, at a minimum, instructive as to the due process implications of taxing a trust with such bare connections to the taxing State.

40. For the same reasons stated above, the Court concludes that the beneficiary's residence in North Carolina, standing alone, is not a sufficient contact by the Trust with this State to support the imposition of the tax at issue, and declines to follow the reasoning in *Gavin*.

41. Accordingly, the Court concludes that the portion of G.S. § 105-160.2 providing that a trust may be taxed on income "that is for the benefit of a resident of this State" violates the Due Process Clause of the United States Constitution and Article I, Section 19 of the North Carolina Constitution as applied to Plaintiff in this case where the only basis for imposition of the taxes is the beneficiaries' residence in the State of North Carolina.

Commerce Clause Analysis

42. Plaintiff also challenges the constitutionality of G.S. § 105-160.2 under the Commerce Clause of the United States Constitution.[48] Contained in Article 1, Section 8, that clause provides Congress with the authority to "regulate Commerce . . . among the several States."[49] As the Supreme Court of the United States has recognized, that Clause "'by its own force' prohibits certain state actions that interfere with interstate commerce." *Quill v. N. Dakota*, 504 U.S. 298, 309 (1992) (quoting *S. Carolina State Highway Dept. v. Barnwell Bros., Inc.*, 303 U.S. 177, 185 (1938)). This "negative sweep" of the Commerce Clause, or dormant Commerce Clause, has been interpreted to place specific limitations on the ability of states to levy taxes on interstate commerce and activity. *Quill*, 504 U.S. at 309.

43. In *Complete Auto Transit, Inc. v. Brady*, the Supreme Court articulated the now well-established four prong analysis for determining the constitutionality of a tax under the Commerce Clause. 430 U.S. 274, 279 (1977); *see also Goldberg v. Sweet*, 488 U.S. 252, 259-260 (1989); *Quill*, 504 U.S. at 311. A state tax withstands scrutiny under the Commerce Clause if: (1) it is applied to an activity with a substantial nexus to the taxing state; (2) it is fairly apportioned so as to tax only the activities connected to the taxing state; (3) it does

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[48] For a thorough discussion of the distinction between the constitutionality of a tax under the Due Process Clause and the Commerce Clause, *see Quill v. N. Dakota*, 504 U.S. 298 (1992).

[49] U.S. Const. art. I, § 8, cl. 3.

not discriminate against interstate commerce; and (4) it is fairly related to services provided by the state. "To pass constitutional muster, *all* four prongs must be satisfied and the failure to meet any one of these requirements renders the tax unconstitutional." *McNeil v. Commonwealth of Pa.*, 67 A.3d 185, 192 (Pa. Commw. Ct. 2013) (citing *Complete Auto Transit, Inc.*, 430 U.S. at 279) (emphasis in original). Because the Court, largely for reasons already discussed above, finds that the application of G.S. § 105-160.2 to Plaintiff fails to satisfy the first and fourth prongs of *Complete Auto*, the Court need not address prongs two and three of that test.

44. The *Complete Auto* test first requires that the activity taxed have a "substantial nexus" to the taxing State. The Supreme Court has explained that, although similar to the minimum contacts required under a due process analysis, the "substantial nexus" required under the Commerce Clause reflects a concern over the impact of State regulation on the national economy and, therefore, requires more than "minimum contacts" with the taxing State. *Quill v. N. Dakota*, 504 U.S. 298, 312-13 (1992). Additionally, the Supreme Court has specifically noted that an entity "may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause." *Id.* at 313.

45. Here, the Court already has found that the Trust itself, as a separate legal entity from its beneficiaries, lacked sufficient "minimum contacts" with North Carolina to satisfy the Due Process

Clause. Similarly, the mere presence of the beneficiaries in North Carolina, while some contact with the State, is not a "substantial nexus" between the Trust and the State of North Carolina. As noted above, all Trust records were compiled and retained outside of North Carolina, all real or personal property held by the Trust was located outside North Carolina, and all income generated by the Trust was generated from investments located outside North Carolina.[50] Accordingly, both the Trust and the income it generated lacked a substantial nexus with this State sufficient to satisfy the *Complete Auto* test.

46. Additionally, the fourth prong of the *Complete Auto* test requires that the tax imposed be fairly related to services provided by the State. This prong ensures that "a State's tax burden is not placed upon persons who do not benefit from services provided by the State." *Goldberg*, 488 U.S. at 266-67 (1989). For this reason, the focus of this prong is on "the presence and activities *of the taxpayer within the State*." *Id.* at 266 (emphasis added). Here, as noted above, Plaintiff had no presence in North Carolina.[51] Plaintiff engaged in no activity in the State of North Carolina; it did not make investments in North Carolina, it made no distributions to North Carolina residents, and it did not maintain any records in North Carolina.[52]

47. On this point, the recent decision of the Commonwealth Court of Pennsylvania in *McNeil v. Commonwealth*, a case factually similar to the

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[50] *See supra* ¶ 23.
[51] *Id.*
[52] *Id.*

present case, is instructive. In *McNeil*, Pennsylvania "assessed Pennsylvania income Tax and interest on all of the income of two inter vivos trusts which are located in, administered in, and governed by, the law of Delaware and which had no Pennsylvania income or assets" on the basis that the trusts' discretionary beneficiaries and settlor were Pennsylvania residents. 67 A.3d at 187-88. The trusts had no obligation to pay any distributions to the beneficiaries and the beneficiaries had no current or future right to the income or assets of the trusts. *See id.* at 194. Pennsylvania law classified the trusts as resident trusts based on the residency of the settlor and taxed the trusts on all of their income. *Id.* at 187, 190. The Court concluded that the tax violated three prongs of the *Complete Auto* test because (a) the residency of the beneficiaries and settlor did not establish a substantial nexus between Pennsylvania and trusts, (b) the tax was not fairly apportioned as the trust had no Pennsylvania income or assets and the trustees had no presence in Pennsylvania, and (c) the tax was not fairly related to services provided by Pennsylvania as the trusts had no physical presence in Pennsylvania, none of their income was derived from Pennsylvania sources, none of their assets or interests were located in Pennsylvania, and they were established under and were governed by Delaware law. *Id.* at 192-97. To be sure, the beneficiaries themselves, as residents of Pennsylvania, received benefits from Pennsylvania; nonetheless, the *McNeil* court made clear that it was the trust that was subject to taxation, not the beneficiaries themselves. *Id.* at 198

(noting the beneficiaries will pay Pennsylvania tax on any distributions they receive from the trusts). Ultimately, the court in *McNeil* recognized that, although the beneficiaries were provided a benefit from the Commonwealth of Pennsylvania, because the plaintiff trusts themselves "d[id] not benefit from Pennsylvania's . . . economic markets, . . . courts, and laws," the fourth prong of *Complete Auto* was not satisfied. *Id.* at 197-98.

48. Similarly, notwithstanding the absence of the Trust's meaningful contact with or activity in North Carolina, Defendant argues that this prong is satisfied because "North Carolina provides the beneficiaries with a civilized society . . . [and] the environment for the enjoyment of the Trust, whether assets are distributed now or later." [53] However, as noted above, the *Complete Auto* test examines the activities "of the taxpayer" in the taxing State. *Goldberg*, 488 U.S. at 266. Defendant has only taxed Plaintiff, not the beneficiaries or any North Carolina resident. Accordingly, the Court is limited to examining the benefit conferred by the State on Plaintiff as a separate legal entity from the beneficiaries. *See Anderson*, 289 U.S. at 27. Unlike the beneficiaries, Plaintiff does not benefit from any services or legal framework provided by the State of North Carolina. *See McNeil*, 67 A.3d at 197-98. Similarly, the Court concludes that application of G.S. § 105-160.2 to Plaintiff does not satisfy the fourth prong of *Complete Auto*.

49. Ultimately, because the application of G.S. § 105-106.2 fails to satisfy the first or fourth prongs of the *Complete Auto* test, the Court concludes that

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[53] Def.'s Br. Supp. Mot. Summ. J. 30.

the portion of G.S. § 105-160.2 providing that a trust may be taxed on income "that is for the benefit of a resident of this State" violates the Commerce Clause of the United States Constitution and Article I, Section 19 of the North Carolina Constitution as applied to Plaintiff in this case where the only basis for imposition of the taxes is the beneficiaries' residence in the State of North Carolina.

Conclusion

50. Although Plaintiff must satisfy a high burden to prove that a State statute is unconstitutional, North Carolina case law has shown that such a burden is not insurmountable. *See McIntyre v. Clarkson*, 254 N.C. 510 (1961) (holding statute at issue constitutionally invalid where challenger showed the statute's unconstitutionality beyond a reasonable doubt). *Accord Board of Managers James Walker Memorial Hospital v. Wilmington*, 237 N.C. 179, 189 (1953); *Rockford-Cohen Group, LLC v. N.C. Dep't of Ins.*, N.C. App. , 749 S.E.2d 469 (2013).

51. Ultimately, after a thorough review of the record in this action and consideration of the arguments of the parties, the Court concludes that Plaintiff has shown, beyond a reasonable doubt, that the portion of G.S. § 105-160.2 providing that a trust may be taxed on income "that is for the benefit of a resident of this State" is unconstitutional under the Due Process and Commerce Clauses of the United States Constitution and Article 1, Section 19 of the North Carolina Constitution as applied to Plaintiff in this case where the only basis for imposition of the

taxes is the beneficiaries' residence in the State of North Carolina. For the reasons stated above, it appears to the Court that Plaintiff's Motion for Summary Judgment should be GRANTED, and Defendant's Motion for Summary Judgment should be DENIED.

THEREFORE, IT IS ORDERED that:

52. Plaintiff's Motion for Summary Judgment is GRANTED. Defendant shall refund any and all taxes and penalties paid by Plaintiff pursuant to G.S. § 105-160.2, with interest.

53. Defendant's Motion for Summary Judgment is DENIED.

This the 23rd day of April, 2015.

No. 18-457

In The
Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST,

Respondent.

On Petition For A Writ Of Certiorari
To The Supreme Court Of North Carolina

BRIEF IN OPPOSITION TO THE NORTH CAROLINA DEPARTMENT OF REVENUE'S PETITION FOR A WRIT OF CERTIORARI

THOMAS D. MYRICK
Counsel of Record
NEIL T. BLOOMFIELD
MOORE & VAN ALLEN PLLC
100 North Tryon Street, Suite 4700
Charlotte, North Carolina 28202
Telephone: (704) 331-1000
tommyrick@mvalaw.com
neilbloomfield@mvalaw.com

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

QUESTION PRESENTED

Did the North Carolina Supreme Court correctly apply settled due process principles to the unique facts of this case, in which the State sought to tax the world-wide income of a trust to which it had no connection based solely on the existence of a discretionary in-state beneficiary?

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INTRODUCTION

This case presents a unique, fact-bound dispute that does not raise any significant question of federal law. The North Carolina Supreme Court correctly followed the well-established due process analysis from this Court and applied it to the unique facts of this action. This Court should deny the petition for three principal reasons.

First, the decision below does not conflict with the decision of any other state court on any question of federal law. The cases the Department cites as establishing a purported conflict present different factual circumstances from one another and from this case that explain their different outcomes. The Department has identified only two states whose highest courts held that the state could tax the accumulated income of an out-of-state trust. The trusts in those cases had more connections with the taxing state than the residence of an in-state beneficiary. In fact, all of the cases relied upon by the Department involve connections to the taxing state other than the residence of the beneficiary; two do not involve a beneficiary residing in the taxing state; and one does not even involve the taxation of a trust. The Department has identified no decision in which a state has attempted, much less succeeded in, the taxation of an out-of-state trust based solely on the presence of a beneficiary. There is no conflict that a decision by this Court would resolve.

Second, this case presents a poor vehicle for addressing the Constitutional implications of state

taxation of out-of-state trusts because it is limited to its facts and the arguments heard by the lower court. This case does not impact the taxation of all trusts. Instead, it relates to the taxation of an out-of-state trust where the only purported connection is the in-state presence of a beneficiary. In the almost 100 years that the North Carolina law has been in existence, no similarly situated trust has filed a challenge. Only four states have similar statutes to North Carolina that even would permit taxation on these facts. And of those four states, none have seen a challenge by a similarly situated trust. In addition, the North Carolina trial court recognized that taxing the trust in these circumstances would violate the Commerce Clause, but the two North Carolina appellate courts found it unnecessary to reach this issue because they held that the tax failed under the Due Process Clause. Because of the unaddressed Commerce Clause implications, a decision by this Court may not finally resolve even this specific litigation. These limitations on both the facts and the law make a review by this Court unwarranted.

Third, the North Carolina Supreme Court correctly reached its decision based on the application of long established precedent of this Court applied to the particular set of facts presented. Due Process demands that where a state seeks to tax, it must have provided some benefit. There is no connection between North Carolina and the trust in this case. And there is no cause for this Court to devote its limited resources to reviewing the application of settled due process principles to a unique factual circumstance.

The petition for certiorari should be denied.

STATEMENT OF THE CASE

I. Background

The Joseph Lee Rice, III Family 1992 Trust (the "Family Trust") was created in New York under an agreement dated December 30, 1992 (the "Trust Agreement") between Joseph Lee Rice III as Settlor (the "Settlor") and William B. Matteson as trustee (the "Initial Trustee"). App. 2a. The Family Trust is governed by New York law. App. 2a. At the Family Trust's creation there were no connections to North Carolina:

- The Settlor was a resident and domiciliary of New York, App. 44a;
- The Initial Trustee was a resident and domiciliary of New York, App. 44a;
- The primary beneficiaries of the Family Trust were the Settlor's descendants, none of whom were residents of North Carolina, App. 44a;
- The contingent beneficiaries of the Family Trust were the Settlor's spouse and sister, none of whom were residents of North Carolina, App. 44a–45a;
- All of the assets of the Family Trust were located outside of North Carolina, App. 3a; and

- The Family Trust was a separate tax paying entity subject to all applicable New York income tax, App. 3a.

Ultimately, pursuant to Section 1.2 of the Trust Agreement, the Family Trust was divided into three separate share trusts, including the Kimberley Rice Kaestner 1992 Family Trust (the "Kaestner Trust"). App. 3a. The separate share trusts continued to be administered by the Trustee under the terms of the Trust Agreement. App. 45a–46a.

The beneficiary of the Kaestner Trust is Kimberley Rice Kaestner. She was a resident of North Carolina during the tax years at issue after moving to the state in 1997. App. 2a. The contingent remainder beneficiaries of the Kaestner Trust were residents of New York (the Settlor's other children and the Settlor's spouse) and Connecticut (the Settlor's sister). *See* App. 44a–45a. Ms. Kaestner has since moved to California; during the time she resided in North Carolina, she received no distributions from the trust.

None of the beneficiaries had any right to withdraw the assets because distributions were made at the sole discretion of the Trustee. App. 3a. No funds were distributed from the Kaestner Trust during the relevant tax years. App. 3a. The beneficiaries also had no role in the management of the Kaestner Trust's assets; the Trustee had and exercised sole discretion to make all investment decisions. App. 46a.

The facts are undisputed. The Department "concedes that the only 'connection between the [Kaestner]

Trust and North Carolina in the case at hand is the residence of the beneficiaries.'" App. 54a.

II. Procedural History

At every level, North Carolina courts were confronted with the same issue—whether the Constitution prohibited the state from taxing a foreign trust based solely on the presence of an in-state beneficiary. *See* App. 1a; App. 27a; App. 41a. And at every level, the North Carolina courts correctly held that the State's tax of a foreign trust was unconstitutional.

The North Carolina Business Court held that the State's attempt to tax the Kaestner Trust violated the Due Process Clause. The Business Court did not take an outdated, formalistic approach as the Department alleges. In citing this Court's decision in *Quill Corp. v. North Dakota*, the Business Court held that where a party is not physically located in the taxing state, the taxed entity must "'purposefully avail[]' itself of the benefits, economic and otherwise, and the laws of North Carolina." App. 53a. The Business Court further concluded under the second prong of the *Quill* due process analysis that the income attributed to North Carolina—all of the Kaestner Trust's worldwide income—was not rationally related to the connection to the state. App. 57a. The Business Court then followed this Court's holding in *Complete Auto Transit, Inc. v. Brady* in holding that the State's tax also violated the Commerce Clause. App. 67a–68a.

The Court of Appeals unanimously affirmed the Business Court. The Court of Appeals relied on this Court's decision in *Brooke v. Norfolk* in holding that the Due Process Clause prohibited North Carolina from taxing a foreign trust based solely on the residence of a beneficiary. App. 38a–40a; *see also Brooke v. Norfolk*, 277 U.S. 27, 28–29 (1928). The Court of Appeals did not reach the Commerce Clause challenge because it was unnecessary.

The North Carolina Supreme Court affirmed the decision of the Court of Appeals. Like the lower courts, the North Carolina Supreme Court considered whether the State could tax the Kaestner Trust "solely based on the North Carolina residence of the beneficiaries during the tax years 2005 through 2008." App. 2a. The court cited this Court's decision in *Anderson v. Wilson* for the proposition that a trust is a separate entity for income tax purposes. App. 12a; *see Anderson v. Wilson*, 289 U.S. 20, 27 (1933). It then relied on this Court's decision in *Walden v. Fiore* and *Hanson v. Denckla* to conclude that the trust cannot satisfy the minimum contact requirements based on the activity of a third party. App. 13a; *see Walden v. Fiore*, 571 U.S. 277, 284–85 (2014); *Hanson v. Denckla*, 357 U.S. 235, 253 (1958). Finally, the North Carolina Supreme Court distinguished *Gavin* and *McCulloch* in favor of this Court's analysis in *Quill* in deciding that North Carolina's taxation of the Kaestner Trust violated Due Process. App. 14a–17a.

REASONS FOR DENYING THE PETITION

This Court should deny the Petition because, contrary to the Petitioner's efforts to inflate its significance, the case presents only the narrow question of whether a state's attempt to tax a foreign trust based solely on the presence of an in-state beneficiary violates the Due Process Clause. The case is not a part of any split of authority. North Carolina is the only state to address the validity of a statute that provides for the taxation of a foreign trust based solely on the in-state residence of a beneficiary. This is a fact-bound case that was correctly decided below and would have limited precedential value because of the unique facts and the limitations on the arguments ruled upon. This Court's review is not warranted.

I. *Kaestner* Is Not Part of a Conflict Among the Courts of Different States

The Kaestner Trust is unique. No case cited by the Department or by the courts below addressed a trust where the only possible connection to the state for minimum contacts analysis was the in-state presence of a beneficiary. The cases the Department does cite are inapposite. The two cases emphasized by the Department throughout this litigation and the six cases it has added to their argument to manufacture a split of authority all address the due process rights of trusts that have connections to the taxing state that do not exist here. Five of these cases have held that the tax violates the Constitution and therefore do not support review.

The three remaining cases all involve multiple connections to the taxing state.

A. The North Carolina Supreme Court's Decision Is Based on a Unique Set of Facts

The North Carolina Supreme Court held that Section 105-160.2 of the North Carolina General Statutes, as applied to the Kaestner Trust, violated the Due Process Clause of the Fourteenth Amendment because the Trust did not have sufficient minimum contacts with North Carolina. In considering the Kaestner Trust's "as applied challenge ... [the court] look[ed] to whether the statute is constitutional in the limited context of the facts of the case before" them. App. 9a. The court considered whether the Department could tax the Kaestner Trust's income "solely based on the North Carolina residence of the beneficiaries during tax years 2005 through 2008." App. 2a.

No court has been confronted with the stark fact pattern presented here. The Kaestner Trust has no connection to North Carolina. The Family Trust was created in 1992 when both the Settlor and the initial trustee were New York residents. App. 43a–44a. The Family Trust was created under New York law and the Trust Agreement provides that New York law governs the trust in all respects. App. 2a. In 1997, five years after the Family Trust was created, the beneficiary moved to North Carolina. App. 2a. She has since moved to another state.

At all relevant times after the Kaestner Trust was formed as a separate share trust, the beneficiary did not receive any distributions of funds, including during the period when she resided in North Carolina. App. 3a. All of the Kaestner Trust's assets were located outside of North Carolina. App. 3a. All of the business of the Kaestner Trust took place in New York—its attorneys were located in New York; its financial books and records were located in New York; the custodian of the trust's assets was in Massachusetts, and its tax returns and accountings were prepared in New York. App. 45a–46a. The Trustee generated income exclusively from investments outside of North Carolina. App. 65a.

The Trustee made all the decisions for the Kaestner Trust. App. 46a. The beneficiary had no control over the management of the Kaestner Trust or the distribution of its funds. App. 46a. In fact, the beneficiary was not even aware of its existence until nine years after she had moved to North Carolina.

In 2005 through 2008, the Department taxed all of the accumulated, worldwide income of the Kaestner Trust on the sole basis that Ms. Kaestner, a discretionary beneficiary of the trust, was a North Carolina resident during the tax years at issue. App. 4a.

Every other state that sought to tax a trust in the cases cited by the Department had a connection to the trust that does not exist here.

B. No Court Has Held that a Beneficiary's Presence Is Sufficient to Tax the Undistributed Income of a Foreign Trust

The cases invoked in the Petition do not establish any split of authority with this case. Two of these cases do not present a conflict because, even with the presence of connections to the taxing state that are not present here, the courts concluded that the tax was unconstitutional. Three of the cases are decisions of lower level state courts that all similarly concluded that taxation was unconstitutional. Of the remaining three cases, all are distinguishable because they (i) are not decided based on a state statute permitting taxation based solely on the residency of the beneficiary, (ii) the trusts have connections with the taxing state that are not present here, and (iii) one involves taxation of funds held by the in-state beneficiary.

1. The *Fielding* and *Mercantile-Safe Deposit* Courts Found Taxation of a Foreign Trust Violates the Due Process Clause Despite the In-State Presence of a Beneficiary and Grantor

The Minnesota Supreme Court in *Fielding v. Commissioner of Revenue* and the Court of Appeals of New York in *Mercantile-Safe Deposit & Trust Co. v. Murphy* both held that the state's taxation of the trust violated the Due Process Clause of the Fourteenth Amendment. *Fielding*, 916 N.W.2d 323, 334 (Minn. 2018), petition for cert. filed, *Comm'r of Rev. v. Fielding*, No. 18-664 (Nov. 15, 2018); *Mercantile-Safe Deposit & Tr. Co.*, 203

N.E.2d 490, 581 (N.Y. 1964). Both courts concluded that Due Process prohibited taxation even though, unlike in this case, the trusts had connections to the taxing state beyond an in-state beneficiary.

The relevant statute in *Fielding*, Section 290.01 of the Minnesota Statutes, defines a resident trust as "an irrevocable trust, the grantor of which was domiciled in this state at the time the trust became irrevocable." Minn. Stat. § 290.01, subd. 7b.(a)(2). Unlike this case, the grantor of the trusts was a resident of the taxing state when the trusts became irrevocable, and some of the *Fielding* trusts' income was derived from sources in Minnesota. *Fielding*, 916 N.W.2d at 330. Despite these additional connections, the Supreme Court of Minnesota held that the trust "lack[ed] sufficient relevant contacts with Minnesota during the applicable tax year to be permissibly taxed consistent with due process." *Id.* at 325.

The *Mercantile-Safe Deposit* court had to determine whether New York could tax "a nonresident trustee of an *inter vivos* trust created in Maryland by a resident of New York." 19 A.D.2d 765, 765 (N.Y. App. Div. 1963), *aff'd*, 203 N.E.2d 490 (N.Y. 1964). Both the grantor of the trust and the trust's beneficiary were New York residents. *Id.* Despite the in-state presence of the grantor and the beneficiary, the New York Court of Appeals held that the state could not tax the accumulated income of the trust. 203 N.E.2d at 581.

2. Three Lower Courts Found that Taxation of a Trust Violates the Due Process Clause Despite the In-State Presence of the Grantor

The Department cites three lower court decisions from Illinois, Michigan, and New Jersey, none of which supports the petition for this Court's review. Each of those decisions rejected taxation of trusts that had connections to the taxing state that are not present here. None of the relevant statutes permitted taxation based solely on the in-state presence of a beneficiary. None of the non-contingent beneficiaries resided in the taxing state. And even if these cases were on point, which they are not, these are cases decided by a trial court and two intermediate state appellate courts; the highest courts of these states should be permitted to address the issue before review by this Court may be warranted or appropriate.

In *Linn v. Department of Revenue*, the issue before the Appellate Court of Illinois was whether the state could tax a trust whose only connections to the state was that the *grantor* was a resident of Illinois at the time the trust was made irrevocable. 2 N.E.3d 1203, 1209–11 (Ill. App. Ct. 2013). The beneficiaries of the trust did not reside in Illinois. *Id.* at 1210. The Illinois statute at issue provides that an irrevocable trust is a resident of Illinois, and thus can be taxed pursuant to 35 Ill. Comp. Stat. § 5/201(a), when "the grantor [of the trust] was domiciled in this State at the time such trust became irrevocable." *Id.* at 1208 (quoting 35 Ill. Comp. Stat. § 5/1501(a)(20)(D) (2006)). The *Linn* court

held that Illinois could not tax a trust where the trust's only connection with the state was the fact that the grantor of the trust resided in Illinois. *Id.* at 1211. *Linn* therefore did not even address the question that the Department seeks to present here.

Similarly, in *Potter v. Taxation Division Director*, the New Jersey Tax Court addressed whether the state's taxation of the accumulated income of the trust based on the residency of the grantor violated the Due Process Clause. 5 N.J. Tax 399, 404–05 (N.J. Tax Ct. 1983). The New Jersey statute provides that the state can tax the accumulated income of a trust if the grantor resided in the state at the time the trust became irrevocable. N.J. Stat. § 54A:1-2. In *Potter*, the settlor of the trust resided in New Jersey. 5 N.J. Tax at 402. But the trustee and non-contingent beneficiaries resided outside the state.[1] *Id.* at 403. The New Jersey Tax Court held that the state did not have sufficient contacts to tax the trust when the only relationship between the trust and the state was that the grantor was a New Jersey resident. *Id.* at 404–05.

In *Blue v. Department of Treasury*, the Michigan Court of Appeals addressed whether the state could lawfully tax the accumulated income of a trust where the trust was created by a Michigan settlor, but had no other connections to the state. 462 N.W.2d 762, 763 (Mich. Ct. App. 1990). The Michigan statute provides

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[1] The New Jersey Tax Court noted that the contingent beneficiaries resided in New Jersey, but did not consider that as a connection between the trust and the state. *Id.* at 405.

that the state may tax a trust that was created by a Michigan resident. Mich. Comp. Laws § 206.18(1)(c); *see also Blue*, 462 N.W.2d at 763. Neither the beneficiary nor the trustee was a resident of Michigan. *Blue*, 462 N.W.2d at 763. The Michigan Court of Appeals held that the trust did not have sufficient contacts with the state when the trust's only connection to the state was that the settlor was a Michigan resident. *Id.* at 764.

These decisions are inapposite and are not by the highest courts of these states and therefore do not provide a reason for this Court to review the unique facts of this case.

3. The Remaining Three Cases from California, Connecticut, and Missouri Reject Due Process Challenges But the Taxpayers All Have Connections to the Taxing State that Do Not Exist Here

The remaining three cases on which the Department relies present fundamentally different facts. The Department has repeatedly emphasized the Supreme Court of California's decision in *McCulloch v. Franchise Tax Board* and the Connecticut Supreme Court's decision in *Chase Manhattan Bank v. Gavin*. *McCulloch*, 390 P.2d 412 (Cal. 1964); *Gavin*, 733 A.2d 782 (Conn. 1999). The North Carolina Supreme Court correctly distinguished these cases. App. 14a–17a. The Department now also cites *Westfall v. Director of Revenue*, 812 S.W.2d 513 (Mo. 1991), an almost 30-year-old case

which it has never previously relied upon and which does not assist it here. Each of these cases involved statutes that did not permit taxation based solely on the beneficiary's residence and the trusts at issue had contacts with the taxing state that are not present here.

As the North Carolina Supreme Court noted, *McCulloch v. Franchise Tax Board* is distinguishable from the instant case on a number of grounds—(i) California taxed the distribution in the hands of the in-state beneficiary, not the out-of-state trust and (ii) the California resident beneficiary was also a trustee. *See* 390 P.2d at 414.

The statute at issue in *McCulloch* provides that a resident beneficiary—not the trust—may be taxed for income accumulated by the trust and distributed to the beneficiary.[2] *See* 390 P.2d at 416; *see also* Cal. Rev. &

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[2] The Supreme Court of California did not address the constitutionality of the separate California statute providing that a trust may be taxed on its accumulated income when the trustee *or* beneficiary is a resident of the state. Cal. Rev. & Tax Code § 17742 (providing that the state can tax the entire taxable income of a trust "if the fiduciary or beneficiary (other than a beneficiary whose interest in such trust is contingent) is a resident, regardless of the residence of the settlor") (emphasis added). But at least one justice deciding *McCulloch* was aware of the potential constitutional challenges a state would face when directly taxing a foreign trust. Justice Roger Traynor recognized that taxation of a trust based on the residency of a beneficiary would be difficult. *See* Roger John Traynor, *State Taxation of Trust Income*, 22 Iowa L. Rev. 268, 278 (1936-1937). Justice Traynor concluded that to tax accumulated income of a trust, a state should tax the income after it was distributed to the in-state beneficiary. *Id.* at 275,

Tax Code § 17745(a). In *McCulloch*, the Supreme Court of California acknowledged that "[t]he purpose of section 18106 of the Revenue and Taxation Code," the statute at issue, "is to avoid the difficulties which the state might otherwise encounter in attempting to enforce tax collection directly against foreign trustees." 390 P.2d at 420. The Supreme Court of California held that "California can constitutionally tax the beneficiary at the time he receives the accumulated income." *Id.* at 414.

Even if California had taxed the income in the hands of the trust, the case is distinguishable because the in-state beneficiary was also a trustee. The *McCulloch* court relied upon the well-established principle that a state may "tax the entire income of a discretionary trust administered by a resident trustee whether he elects to distribute any part of such income or not." *Id.* at 420–21 (citing *Guaranty Trust Co. v. Virginia*, 305 U.S. 19, 22 (1938)). Accordingly, the Supreme Court of California held that "[n]o possible doubt attaches to California's constitutional power to tax plaintiff as a trustee." *Id.* at 421. The *McCulloch* opinion contains a discussion of whether the beneficiary's residency on its own could establish a sufficient connection to tax the accumulated income of the trust, but this discussion is dicta because the *McCulloch* court taxed the beneficiary, not the trust and that beneficiary was also a trustee.

279–80. That is exactly what Section 18106, now codified at Cal. Rev. & Tax Code § 17745, allows.

The Department's reliance on *Chase Manhattan Bank v. Gavin* is also misplaced. 733 A.2d 782. In *Gavin*, the Connecticut Supreme Court addressed different statutory language applied to different facts. The Connecticut statute provides that a resident *inter vivos* trust is "a trust, or portion of a trust, consisting of the property of (i) a person who was a resident of this state at the time the property was transferred to the trust if the trust was then irrevocable. . . ." *Id.* at 789 (citing Conn. Gen. Stat. § 12-701(a)(4)(D)). The beneficiary and the settlor of the trust were residents of Connecticut. *Id.* at 787–88. Unlike the action here, the beneficiary's residency was not the sole contact relied upon by the Connecticut Supreme Court.

The Missouri Supreme Court's decision in *Westfall v. Director of Revenue* is also inapposite. 812 S.W.2d 513. The Missouri statute provides that the state can tax a trust if either the settlor or grantor of the trust is a resident of the state and at least one income beneficiary resides in the state.[3] *Id.* at 514. The *Westfall* trust had four contacts with the state—(1) the settlor resided in Missouri, (2) the trust was created in Missouri, (3) property generating income for the trust was located in Missouri, and (4) two contingent beneficiaries were located in Missouri. *Id.* at 514. The

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[3] Mo. Rev. Stat. § 143.331 (defining a resident trust as a trust that was either (1) "created by will of a decedent who at his or her death was domiciled in this state" or (2) "created by, or consisting of property of, a person domiciled in this state on the date the trust or portion of the trust became irrevocable" and "[h]as at least one income beneficiary who, on the last day of the taxable year, was a resident of this state.").

Missouri Supreme Court's decision was based on all of these connections.

There is no split in authority among the states on the issue of whether the beneficiary's presence alone is sufficient to tax a foreign trust. There are no other cases. The cases cited by the Department simply underscore why review of the decision below would be unwarranted and inappropriate. Each of those cases turns on its particular set of facts, none of which is the same as the unique factual situation presented here.

II. This Case Is a Poor Vehicle for Addressing Constitutional Implications of State Taxation of Out-of-State Trusts and Would Have Limited Precedential Value

A decision on the facts of this case would provide limited guidance for courts addressing the taxability of trusts. First, as discussed above, the factual scenario in which the only purported connection between the taxing state and the out-of-state trust was the presence of the in-state beneficiary has never been litigated in any other state. Second, only five states, including North Carolina, have statutes that permit taxation based on the in-state presence of a beneficiary, which limits where this type of case could arise. Third, the North Carolina Supreme Court's analysis was limited to the Due Process Clause. Foreign-state taxation of a trust based on the contacts presented here also raises issues under the Commerce Clause, which were

not briefed for or addressed by the North Carolina Supreme Court, and should not now be addressed by this Court.

A. This Case Presents a Unique Fact Pattern that Has Never Been Challenged

This case is limited to the North Carolina Supreme Court's decision addressing taxation in the unique situation where the trust's sole connection to the state is the in-state residency of the beneficiary. *See infra.* Section I.A. Contrary to the Department's assertions about the financial implications of this holding, the North Carolina court's decision is likely to have very little, if any, financial impact outside this litigation.

Only five states, including North Carolina, have statutes that as a theoretical matter would permit taxation solely on the basis of an in-state beneficiary. Even in those five states, there has not been a legal challenge by a similarly situated trust. Indeed, the Department observes that North Carolina's tax has not been challenged in the ninety-five years of its existence. That is almost certainly because most of the trusts paying taxes under the statute, unlike the Kaestner Trust, had some connection to North Carolina.

For another case to arise like this one, all of the following eight factors would need to be true: (1) the trustee is not a resident of the state; (2) the grantor or settlor of the trust is not a resident of the state; (3) the trust is administered outside the state; (4) there is at

least one in-state beneficiary; (5) all of the trust's income is generated from sources outside the state; (6) all of the trust's assets are located out-of-state; (7) the trust is not governed by the state's laws; and (8) the trust has not distributed the income to the in-state beneficiary.

These factors have coalesced one time.[4] It is this case.

B. There Are Only Four States with Similar Statutes that Could Possibly Have a Similar Case and None Have Decided this Issue

Forty-five states have chosen not to permit taxation of a trust based solely on a beneficiary's residence. The North Carolina statute provides that the state may tax "the amount of the taxable income of the estate or trust that is for the benefit of a resident of this State." N.C. Gen. Stat. § 105-160.2. Only four other

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[4] The Department states for the first time, and without any support in the record, that it has received "more than 450 contingent income-tax returns from trusts that are awaiting the outcome of this petition." (Pet. for Writ of Cert. at 13.) The Department provides no information about whether the referenced trusts remotely resemble the current trust, on what basis these returns were filed, and whether any particular return would be affected by the outcome of this case. This Court should disregard this vague outside-the-record assertion. *See* Sup. Ct. R. 14.1(g) (requiring that the statement of the case in a petition for certiorari rely on "specific portions of the record or summary thereof, with specific reference to the places in the record where the matter appears").

states[6] have statutes that provide for taxation of undistributed income of trusts based on nothing more than the residency of a beneficiary—California, Georgia, North Dakota[6], and Tennessee.[7] And none of these states have addressed whether the Constitution would permit taxation solely on that basis.

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[5] *See* Cal. Rev. & Tax Code § 17742 (explaining that "the entire taxable income of a trust" is taxable to the trust "if the fiduciary or beneficiary (other than a beneficiary whose interest in such trust is contingent) is a resident, regardless of the residence of the settlor"); Ga. Code Ann. § 48-7-22(a)(1)(c) (imposing an income tax upon resident fiduciaries and nonresident fiduciaries who are "[m]anaging funds or property for the benefit of a resident of this state"); N.D. Admin. Code § 81-03-02.1-04 (defining a resident trust as a trust that "has a relationship to the state sufficient to create nexus," including the fact that "[a] beneficiary of the trust or estate is a domiciliary or resident of this state"); Tenn. Code Ann. § 67-2-110 ("Trustees, guardians, administrators, executors, and other persons acting in a fiduciary capacity who receive income taxable under this chapter for the benefit of residents of Tennessee shall be required to make returns under this chapter and to pay the tax levied by this chapter.").

[6] Unlike North Carolina's statute, North Dakota does not explicitly provide that the state can tax solely based on the presence of an in-state beneficiary. Instead, North Dakota's statute suggests that the residence of a beneficiary may be sufficient on its own to create a nexus with the state; however, it also lists five other contacts that may be considered when assessing whether there is a nexus with the state. N.D. Admin. Code § 81-03-02.1-04. The language of the statute is ambiguous and has not been interpreted by the North Dakota Supreme Court.

[7] Unlike North Carolina, Tennessee only taxes "on incomes derived by way of dividends from stocks or by way of interest on bonds." Tenn. Code Ann. § 67-2-102. Further, Tennessee has enacted a bill that completely eliminates the income tax in 2022. *See* Tenn. Code Ann. § 67-2-124; Tenn. Pub. Acts 181 § 15.

The Supreme Court of California in *McCulloch* did not address this issue. Section 17742 provides that the state can tax "the entire taxable income of a trust, if the fiduciary or beneficiary . . . is a resident, regardless of the residence of the settlor." Cal. Rev. & Tax Code § 17742. But in *McCulloch*, the Supreme Court of California upheld a tax on the beneficiary—not the trust—under Section 18106, now codified at Section 17745. *McCulloch*, 390 P.2d at 416. There are no cases for the other three states that are remotely on point.

The other six states cited by the Department do not allow for the taxation of undistributed tax income based solely on the in-state residency of a beneficiary. Instead, those six states require both the in-state presence of at least one beneficiary *and* that the grantor of the trust was a resident of the state at the time the trust was made irrevocable.[8]

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[8] *See* Ala. Code § 40-18-1 (defining a resident trust as a trust created "by a person who was an Alabama resident at the time such trust became irrevocable" and "either a fiduciary of the trust or a beneficiary of the trust to whom distributions currently may be made" resides in the state); Mont. Admin. R. § 42.30.101(16)(c) (defining resident trust to include "any irrevocable trust created by, or consisting of property of, a Montana resident on the date the trust or portion of the trust became irrevocable and has at least one income beneficiary who, for all or some portion of the trust's current taxable year, was a Montana resident"); Mo. Rev. Stat. § 143.331(3) (defining resident trust to include "[a] trust that: (a) [w]as created by, or consisting of property of, a person domiciled in this state on the date the trust or portion of the trust became irrevocable; and (b) [h]as at least one income beneficiary who, on the last day of the taxable year, was a resident of this state"); Ohio Rev. Code Ann. § 5747.01(I)(3)(a) ("A trust resides in this state for the trust's current taxable year to the extent . . . that the

C. This Case Is Limited to the Due Process Clause and Would Likely Return on Commerce Clause Grounds If the Department Was Successful

The Due Process Clause and the Commerce Clause "pose distinct limits on the taxing powers of the States," meaning "a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer," but "imposition of the tax may nonetheless violate the Commerce Clause." *Quill Corp. v. North Dakota*, 504 U.S. 298, 305 (1992). This Court has explained that the Commerce Clause imposes limits upon a state's ability to tax interstate commerce and activity. *See Goldberg v. Sweet*, 488 U.S. 252, 259

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trust consists . . . of assets . . . that were transferred . . . to the trust by . . . [a] person who was domiciled in this state for purposes of this chapter when the person directly or indirectly transferred assets to an irrevocable trust, but only if at least one of the trust's qualifying beneficiaries is domiciled in this state for the purposes of this chapter during all or some portion of the trust's current taxable year."); Conn. Gen. Stat. § 12-701(a)(4) (defining a resident trust to include an irrevocable trust "consisting of the property of (i) a person who was a resident of this state at the time the property was transferred to the trust if the trust was then irrevocable" or "a person who . . . was a resident of this state at the time the trust became irrevocable" and noting that the taxable income of the trust is modified if all the non-contingent beneficiaries do not reside within the state); R.I. Gen. Laws § 44-30-5(c)(4)(5) (defining a resident trust to include "[a]n irrevocable trust created by or consisting of property contributed by a person who is a resident individual in this state at the time the trust was created" and "the beneficiaries are Rhode Island resident individuals").

(1989); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

This case does not present an opportunity to address the Commerce Clause. The validity of a state tax under the Commerce Clause is determined by the four-part test set forth by this Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). Under the *Complete Auto* test, a state complies with the Commerce Clause if: "the tax (1) is applied to an activity with a substantial nexus with the taxing State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the State." *Quill Corp.*, 504 U.S. at 311 (quoting 430 U.S. at 279). If a tax does not satisfy all four elements of the *Complete Auto* test, then it must be struck down for violating the Commerce Clause. *Complete Auto Transit*, 430 U.S. at 279. Given the Kaestner Trust's lack of connection to North Carolina, it is unlikely that it could pass any of these four prongs, but it certainly could not pass all four.

There are cases where lower courts have ruled on both points. At least three of the eight cases cited by the Department in support of a purported split raised both Due Process and Commerce Clause challenges.[9]

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[9] *Fielding v. Comm'r of Rev.*, 916 N.W.2d 323, 327 (Minn. 2018) ("Having decided the case on due process grounds, the Tax Court did not reach the Trusts' claims under the Commerce Clause."); *Linn v. Department of Revenue*, 2 N.E.3d 1203, 1211 (Ill. App. 2013) (explaining that the court did not need to address plaintiff's commerce clause argument because it found the taxation of the trust to violate the due process clause); *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 806 (Conn. 1999) (holding that

Other cases cited by the Department throughout this litigation have also asserted Commerce Clause challenges where the state taxed the undistributed income of a trust.[10]

Thus, a decision by this Court may not finally resolve even this fact-bound dispute. If the Court were to grant review and decide that that state's extraterritorial taxation does not violate the Due Process Clause, the litigation would continue and could return on Commerce Clause grounds.

D. This Case Does Not Present Issues of Federalism or an Opportunity to "Modernize" Trust Law

The Department's arguments based on federalism and the purported need to "modernize" trust jurisprudence lack merit. Federalism does not stand for the principle that one state should be able to exercise the power to tax over a resident of another state. Nor is review appropriate in order to "modernize" this Court's trust law jurisprudence; this is a solution looking for a problem. Trust law has been around since the 12th century and neither modern technology nor the facts of this case have done anything to cause this Court to

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"the incentives and risks have not been sufficiently established so as to result in a dormant commerce clause violation").

[10] *See, e.g.*, *McNeil v. Commonwealth*, 67 A.3d 185, 195 (Pa. Commw. Ct. 2013) (holding that Pennsylvania's taxation of the Trust's income violated the Commerce Clause where the trust's only purported connections to the state was the residency of the settlor and beneficiaries).

revisit and upset settled understandings about the relationship between a trust and beneficiary.

A state cannot invoke federalism principles to justify imposing a tax on an entity with no connection to that state. It is ironic that the Department cites *McCulloch v. Maryland* to support its argument that the North Carolina Supreme Court's decision challenges principles of federalism. In *McCulloch v. Maryland*, the Supreme Court prevented the state from taxing a federal institution within its borders because the state could claim no control over it. 17 U.S. 316, 430 (1819). What the Department attempts to do here—to reach outside its borders to tax an entity under control of and receiving the protection of another state—is far beyond what this Court rejected in *McCulloch v. Maryland*. This Court has continually imposed limits on a state's power to tax out-of-state entities without thwarting the general principle that states have the power to tax entities over which the state's sovereignty extends. *See, e.g.*, *Quill Corp.*, 504 U.S. at 305; *Complete Auto Transit*, 430 U.S. at 279; *Hanson*, 357 U.S. at 253; *Safe Deposit & Tr. Co. v. Virginia*, 280 U.S. 83, 92 (1929); *Brooke*, 277 U.S. at 28–29.

The North Carolina Supreme Court's decision does not impose an "extraordinary imposition" on the state. Instead, it requires that the state comply with the well-established principles governing Due Process. To tax an out-of-state entity the state must demonstrate that the entity has some connections with the state and "that the 'income attributed to the State for tax purposes must be rationally related to values

connected with the taxing State.'" *Quill Corp.*, 504 U.S. at 306 (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978)).

The Department incorrectly states that this Court has not provided guidance concerning the taxation of trusts since the "*Pennoyer* era of due-process," which was decided in 1878. (Pet. for Writ of Cert. at i.) The Department contradicts the statement twice in its own petition—first, stating that it has been ninety years since the Court has addressed taxation of a trust, then changing the calculation to seventy years. (Pet. for Writ of Cert. at i, 15.)

Ultimately it is irrelevant how long it has been since the Court has addressed this issue. The correct question is whether there are "compelling reasons" to warrant the Court to readdress the issue. Sup. Ct. R. 10. This Court has noted that "any departure from the doctrine of *stare decisis* demands special justification." *Arizona v. Rumsey*, 467 U.S. 203, 212 (1984). The Department has failed to provide any compelling reason for this Court to grant its Petition or any justification for revisiting well-established precedent.

The Department suggests that the Due Process principles applicable to trusts should be "modernized," comparing the circumstances of this case to those in *Wayfair*. The comparison is inapt. In *Wayfair*, unlike in this case, the outcome of the case had significant implications. "Forty-one States, two Territories, and the District of Columbia" asked the Court to revisit the Commerce Clause physical presence rule as applied to

sales tax. *South Dakota v. Wayfair, Inc.*, ___ U.S. ___, 138 S. Ct. 2080, 2086 (2018). The issue presented has only been addressed by North Carolina and at most this decision could impact only the five states with statutes permitting taxation of undistributed income of an out-of-state trust based solely on the residency of the beneficiary.

In *Wayfair*, this Court held that the Commerce Clause physical presence rule "must give way to the 'far-reaching systemic and structural changes in the economy' and 'many other societal dimensions' caused by the Cyber Age." *Id.* at 2097 (quoting *Direct Mkt. Ass'n v. Brohl*, 575 U.S. ___, 135 S. Ct. 1124, 1135 (2015) (Kennedy, J., concurring)). But there have been no changes or modernization of trusts that require a corresponding modernization of the Due Process analysis used to determine whether a state can tax an out-of-state trust. Further, unlike the Commerce Clause physical presence rule, the Due Process minimum contacts analysis has not been applied in formalistic and rigid manner dating back to at least *Quill* and its test for purposeful availment.

III. All of the North Carolina Courts Correctly Decided that the State's Tax Was Unconstitutional as Applied to the Kaestner Trust

There is no need to grant the petition to correct error in this case because there is none. The Due Process Clause prohibits a state from taxing the income of an entity, unless the entity has some minimum

connection to the state and the tax is rationally related to the values the entity derives from the taxing state. *Quill Corp.*, 504 U.S. at 306. Longstanding precedent from this Court on the issue of due process prohibits taxation where, as here, the only contact is the presence of a resident beneficiary. A statute that seeks such a tax violates the Constitution.

The Kaestner Trust is a foreign entity. Its only connection to North Carolina is that a beneficiary moved to the state years after the Trust Agreement was executed. The presence of a beneficiary is not sufficient to tax a foreign trust's worldwide income. This Court reached that conclusion in *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929). As in *Safe Deposit*, the North Carolina statute "undertakes to tax things wholly beyond [its] jurisdiction or control" and for that reason "conflicts with the Fourteenth Amendment." 280 U.S. at 92.

The Court provided additional guidance in *Quill* that dictates the same outcome. Under *Quill*, due process requires among other things "some definite link, some minimum connection between a state and the person, property or transaction it seeks to tax." *Quill Corp.*, 504 U.S. at 306. In the case of trusts, the connections must be to the trust. "[T]he law has seen fit to deal with this abstraction [i.e., a trust] for income tax purposes as a separate existence." *Anderson v. Wilson*, 289 U.S. 20, 27 (1933).

Where the only alleged connection is the residence of an in-state beneficiary, *Safe Deposit* and *Quill* align

to stand for the proposition that the in-state residence of a beneficiary is not alone a sufficient definite link or minimum connection between a state and the trust it seeks to tax.

Even if the beneficiary were to constitute some minimum connection, which it does not, "the income attributed to the State for tax purposes . . . [must] be rationally related to 'values connected with the taxing State.'" *Quill Corp.*, 504 U.S. at 306 (quoting *Moorman Mfg. Co.*, 437 U.S. at 273); *see Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, 134–35 (1931) (finding that taxing 80% of the taxpayer's income when only 17% was sourced within the taxing state was out of proportion to the business transacted within the state). There is no rational relationship here. The Kaestner Trust held all of its assets outside the state and all of its income was generated from sources outside of North Carolina. The Department taxed 100% of the trust's income while providing no opportunity to the Kaestner Trust to create that income.

CONCLUSION

The petition should be denied.

Respectfully submitted,

THOMAS D. MYRICK
Counsel of Record
NEIL T. BLOOMFIELD
MOORE & VAN ALLEN PLLC
100 North Tryon Street, Suite 4700
Charlotte, North Carolina 28202
Telephone: (704) 331-1000

November 30, 2018

No. 18-457

In The Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of North Carolina

REPLY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

ROBERT F. ORR
ROBERT F. ORR, PLLC
3434 Edwards Mill Rd.
Suite 112-372
Raleigh, NC 27612
(919) 608-5335

ANDREW H. ERTESCHIK
SAAD GUL
JOHN M. DURNOVICH
NATHANIEL C. ZINKOW
POYNER SPRUILL LLP
Post Office Box 1801
Raleigh, NC 27602
(919) 783-2895

JOSHUA H. STEIN
Attorney General

MATTHEW W. SAWCHAK
Solicitor General
Counsel of Record
JAMES W. DOGGETT
Deputy Solicitor General
NORTH CAROLINA DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400
msawchak@ncdoj.gov

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

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INTRODUCTION

The Trust does not deny that this case presents an important and unresolved question: whether the Due Process Clause prohibits states from taxing trusts based on trust beneficiaries' in-state residency. Instead, the Trust makes three unsuccessful arguments in opposition to the petition.

First, the Trust tries to explain away the direct split among the nine state courts that have considered the question presented. The Trust suggests that there is no conflict because each of these nine decisions is supposedly distinguishable on its facts.

The Trust's approach misses the point: Each of the cited cases decided whether a trust beneficiary's in-state residency permits a state to tax a trust. None of those decisions tethered its legal conclusion to the factual distinctions that the Trust attempts to make. Thus, the Trust's factual distinctions do not diminish the direct split that justifies this Court's review.

Second, the Trust argues that this case is a poor vehicle. Those arguments fail as well.

For example, the Trust is mistaken when it claims that this case would affect only a few states. Six states (including North Carolina) assess taxes solely on the basis of a beneficiary's in-state residency. The validity of those states' trust-taxation statutes hinges on the question presented. In addition, another five states rely on a beneficiary's in-state residency plus other connections with the taxing state. Upholding North

Carolina's statute here would validate the statutes in those states as well. Thus, the question presented affects at least eleven states, as well as any other state that may wish to consider a similar trust-taxation policy in the future.

The Trust also argues that this case is a poor vehicle because it "would likely return" to this Court on Commerce Clause grounds—an independent issue that North Carolina's appellate courts did not reach.

This Court often grants certiorari in cases where the courts below did not address every issue. In those instances, the Court simply grants certiorari on the question presented and, if it rules in the petitioner's favor, remands for the lower courts to consider the remaining issues. The Trust offers no answer for why that common procedural posture presents a problem here.

Finally, the Trust argues the merits. Its rigid, presence-focused arguments, however, confirm the need for this Court to modernize its trust-taxation jurisprudence. And regardless of which side is right on the merits, certiorari is needed to resolve the state-court split that the petition describes.

In sum, the petition presents an important and unresolved constitutional issue that has divided nine state courts. The Court should grant the petition to resolve the conflict.

ARGUMENT

I. There is a direct split among nine state courts on the question presented.

Nine state courts are divided on whether the Due Process Clause prohibits states from taxing trusts based on trust beneficiaries' in-state residency. The petition recounts the conflicting conclusions on each side of the split. Pet. 9–12.

The Trust's only response is to stress minute factual distinctions among the nine cited decisions. That approach fails, because each of those decisions squarely addressed the question presented, without tethering its decision to the factual distinctions that the Trust attempts to make.

The Trust begins by arguing that the Connecticut Supreme Court's decision in *Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999), is inapposite because the "beneficiary's residency was not the sole contact relied upon by the Connecticut Supreme Court." Opp. 17. But the Trust ignores *Gavin*'s central legal conclusion: The beneficiary's residence is the "critical link" justifying taxation. 733 A.2d at 802 n.25; *see also* Pet. 10. That conclusion directly conflicts with the conclusion reached by the state courts on the other side of the split (Michigan, Minnesota, New Jersey, New York, and North Carolina), each of which considered the beneficiary's residence irrelevant. *See* Pet. 10–12.

Likewise, the Trust tries to dissect the underlying facts of *Linn v. Department of Revenue*, 2 N.E.3d 1203

(Ill. App. Ct. 2013), and *Westfall v. Director of Revenue*, 812 S.W.2d 513 (Mo. 1991), arguing that those cases involved jurisdictional contacts that are not present here. *See* Opp. 12–14, 17–18. But those other facts do not change the courts' key legal conclusions on the due-process consequences of a beneficiary's in-state residency.

In *Linn*, for example, the Illinois Appellate Court relied on *Gavin*'s holding that a beneficiary's residence is the "critical link" that justifies taxation. 2 N.E.3d at 1209. Likewise, in *Westfall*, the Missouri Supreme Court relied on the "domicile of the beneficiaries" within the taxing state as a factor that "support[s] imposition of an income tax on trust income." 812 S.W.2d at 514. Nothing in the Trust's brief reconciles those legal conclusions with the other side of the split.

Next, the Trust claims that the California Supreme Court's decision in *McCulloch v. Franchise Tax Board*, 390 P.2d 412 (Cal. 1964), is irrelevant because it upheld a tax on a beneficiary, not on a trust. Opp. 15–16.[1] But the *McCulloch* court allowed California to tax the beneficiary only after the court decided that taxing the trust itself based on the in-state residency of the beneficiary satisfied due process. 390 P.2d at 417–19. It did so, moreover, on the rationale that a beneficiary's state of residence can tax the trust because "that state

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[1] The Trust also emphasizes that the *McCulloch* beneficiary doubled as one of the trustees. Opp. 16. But the beneficiary's dual roles played no part in the court's holding, as the court made clear. *McCulloch*, 390 P.2d at 421 (describing the trustee's role as an "independent basis" for taxation).

renders to the beneficiary . . . protection incident to his eventual enjoyment of such accumulated income." *Id.* at 419.

Finally, the Trust takes issue with the cases on the other side of the split. Opp. 10–14. It dissects the underlying facts of those cases, arguing that they did not squarely address the question presented. The Trust is in no position to make this argument: It relied on these cases in the courts below.[2]

Regardless, the Trust's attempt to reclassify these cases now is flawed. Each of these cases, notwithstanding their slight factual differences, held that the Due Process Clause prohibits states from taxing trusts based on trust beneficiaries' in-state residency. *See Blue v. Dep't of Treasury*, 462 N.W.2d 762, 764 (Mich. Ct. App. 1990) (holding that only the presence of the "trustee [or] trust property . . . within the state" would justify taxation of the trust); *Fielding v. Comm'r of Revenue*, 916 N.W.2d 323, 331 (Minn. 2018), *petition for cert. filed*, No. 18-664 (Nov. 15, 2018) ("[T]he Minnesota residency of [the] beneficiary . . . does not establish the necessary minimum connection to justify taxing the Trusts' income."); *Potter v. Taxation Div. Dir.*, 5 N.J. Tax 399, 405 (1983) ("The fact that . . . beneficiaries are domiciled in New Jersey does not constitute a contact sufficient to empower New

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[2] *See* Plaintiff-Appellee's New Brief at 31, 38–39, *Kimberley Rice Kaestner Family Trust v. N.C. Dep't of Revenue*, 814 S.E.2d 43 (N.C. 2018) (No. 307PA15-2); Plaintiff-Appellee's Brief at 14–17, *Kimberley Rice Kaestner Family Trust v. N.C. Dep't of Revenue*, 789 S.E.2d 645 (N.C. Ct. App. 2016) (No. 15-896).

Jersey to tax undistributed trust income."); *Mercantile-Safe Deposit & Trust Co. v. Murphy*, 203 N.E.2d 490, 491 (N.Y. 1964) (holding that "the imposition of a tax in the State in which the beneficiaries of a trust reside" on income earned in another state violates due process); *see also* Pet. 10–12 (describing these cases in detail).

In sum, the factual distinctions that the Trust offers are unconnected to the relevant holdings of the nine state courts that have split on the question presented. Nothing in the Trust's brief diminishes that direct split.

II. This case is an ideal vehicle for resolving the question presented.

The Trust argues that four features of this case make it a poor vehicle for resolving the question presented. Those arguments fail as well.

First, the Trust argues that this case has "a unique fact pattern." Opp. 19. But the "unique" fact that the Trust identifies is the Department's emphasis on the trust beneficiary's in-state residency, as opposed to other contacts between the Trust and North Carolina. Indeed, that is precisely why this case is an ideal vehicle: It presents the beneficiary's in-state residency in clean form, allowing the Court to resolve the question presented without the need to consider other types of jurisdictional contacts.[3] Thus, the reason that

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[3] The Trust acknowledges that this case "presents only the narrow question" of whether taxing the Trust "solely on the

the Trust believes this case is "unique" actually makes it a clean vehicle for deciding the question presented.

Next, the Trust suggests that a decision on the question presented would affect only a few states. Opp. 20–21. The Trust is mistaken.

Six states (including North Carolina) assess taxes solely on the basis of a beneficiary's in-state residency.[4] The validity of those states' trust-taxation statutes hinges on the question presented here.

In addition, another five states rely on the beneficiary's in-state residency plus other contacts with the taxing state.[5] Upholding North Carolina's statute here would validate the statutes in those states as well. After all, if this Court were to hold that a beneficiary's in-state residency satisfies due process, that holding would imply that a beneficiary's in-state residency *plus additional* connections with the taxing state would also satisfy due process.

Thus, the question presented affects at least eleven states, as well as any other state that may wish

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presence of an in-state beneficiary violates the Due Process Clause." Opp. 7. That admission undermines the Trust's argument elsewhere in its brief that this case is "fact-bound." *Id.* at 1.

[4] Those states (other than North Carolina) are California, *see* Cal. Rev. & Tax. Code § 17742(a); Georgia, *see* Ga. Code Ann. § 48-7-22(a)(1)(A); Montana, *see* Mont. Admin. R. 42.30.101(16); North Dakota, *see* N.D. Admin. Code 81-03-02.1-04; and Tennessee, *see* Tenn. Code Ann. § 67-2-110(a).

[5] Those states are Alabama, *see* Ala. Code § 40-18-1(33); Connecticut, *see* Conn. Gen. Stat. Ann. § 12-701(a)(4); Missouri, *see* Mo. Rev. Stat. § 143.331(1)(b); Ohio, *see* Ohio Rev. Code Ann. § 5747.01; and Rhode Island, *see* 44 R.I. Gen. Laws § 44-30-5(c).

to consider a new trust-taxation policy in the future. Pet. 12–15 (describing the consequences for other states on future tax policy). For just these eleven states, moreover, billions of dollars of state revenue is at stake—a factor that the Trust does not address.

The Trust also suggests that this case is a poor vehicle because it "would likely return on Commerce Clause grounds if the Department was successful." Opp. 23. That argument fails for two reasons.

First, the existence of an unresolved issue that is independent from the question presented is no impediment to this Court's review. To the contrary, it is a common pattern in cases where the Court has granted certiorari. When this pattern arises, the Court simply grants certiorari on the question presented and, if it rules in the petitioner's favor, remands for the lower court to consider the remaining issue. *See, e.g.*, *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2099 (2018); *Fitzgerald v. Barnstable Sch. Comm.*, 555 U.S. 246, 260 (2009); *Wash. State Grange v. Wash. State Repub. Party*, 552 U.S. 442, 458 n.11 (2008); *Envt'l Def. v. Duke Energy Corp.*, 549 U.S. 561, 581–82 (2007); *Whitman v. Dep't of Transp.*, 547 U.S. 512, 515 (2006); *Muehler v. Mena*, 544 U.S. 93, 102 (2005); *Devenpeck v. Alford*, 543 U.S. 146, 156 (2004); *Meyer v. Holley*, 537 U.S. 280, 291 (2003). Thus, the Trust's Commerce Clause claim has no bearing on whether this case is an appropriate vehicle.

In addition, the Trust's prediction about a return trip to this Court is improbable. Now that the Court

has eliminated the physical-presence rule, *see Wayfair*, 138 S. Ct. at 2099, the Commerce Clause issue in this case involves a straightforward application of this Court's precedents. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). Thus, even if the possibility of a return trip to this Court mattered here, the Trust would have no basis for suggesting that a return trip would be "likely." Opp. 23.

Finally, the Trust insists that no modernization of the Court's precedent is needed. The Trust claims that trust law has not changed since the 12th Century, and that trust law should be immune to the changes that led to the Court's decision in *Wayfair*. There are at least two problems with the Trust's logic.

First, the Court's due-process jurisprudence has evolved dramatically since this Court last considered the states' power to tax trusts based on trust beneficiaries' in-state residency.[6] The petition chronicles the development of the law in this area, and how the Court's only guidance on this issue dates back to the era of *Pennoyer v. Neff*, 95 U.S. 714 (1878). *See* Pet. 15–18. The Trust conspicuously avoids discussing whether that *Pennoyer*-era guidance is still good law.

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[6] The Trust is mistaken when it alleges that the petition contains an error on the age of this Court's precedents. Opp. 27. The petition accurately states that it has been ninety years since the Court addressed (in *Safe Deposit*) whether states can tax trusts based on in-state beneficiaries; it has been seventy years since the Court addressed (in *Greenough*) due-process limits on trust taxation more generally. *See* Pet. i, 15–18.

Second, the profound technological changes since the *Pennoyer* era—most notably, the internet, e-mail, and online banking—have made it much easier for settlors and beneficiaries to avoid state taxes by placing investments in trusts administered in other states.[7] Unlike in the 1920s, when the Court decided *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929), trust assets today move across state lines with a single click of a mouse. Thus, the Trust is mistaken when it says there is no reason to revisit outdated precedent in this area.

For these reasons, this case is an appropriate and timely vehicle to address the question presented.

III. The Trust's arguments on the merits are unavailing.

The Trust ends its brief with several pages of arguments on the merits. These arguments fall short in at least two ways.

First, the Trust's merits discussion highlights the failings of a rigid, presence-based analysis of due process. That analysis, which the court below adopted, theorizes that a trust beneficiary is entirely

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[7] The Trust's brief also reveals this case as an example of how trusts are exploiting a judicially created tax shelter. The Trust engaged a trustee in Connecticut, conducted its business in New York, and existed solely for the benefit of a resident of North Carolina. Yet if the Trust succeeds in this case, none of those states (or any other) will have taxed the full extent of the Trust's income during the tax years at issue.

disconnected from her trust, so her contacts with the taxing state simply do not matter for due-process purposes.

As the petition points out, that formalistic theory conflicts with this Court's modern due-process jurisprudence. That theory also overlooks the fundamental nature of a trust—a legal fiction that exists solely for the benefit of the beneficiary, who holds "an actual property interest in the subject-matter of the trust." *Commonwealth v. Stewart*, 12 A.2d 444, 446–47 (Pa. 1940), *aff'd mem.*, 312 U.S. 649 (1941); *see also* George Gleason Bogert, *The Law of Trusts and Trustees* § 114 (3d ed. 2008); Pet. 18–21. The Trust leaves that fundamental point unrebutted.[8]

In any event, the point of the petition is not to decide which side of the split in authority is right; it is to give this Court an opportunity to decide which side is right. For decades now, the question presented has generated widespread litigation. That litigation has

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[8] The Trust also briefly raises the issue of whether the "income attributed to the State for tax purposes" was "rationally related to values connected with the taxing State." Opp. 30 (quoting *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992)). By focusing only on where its income was generated, the Trust treats this case as if it involved corporate-income taxes. *See id.* (citing *Hans Rees' Sons v. North Carolina*, 283 U.S. 123 (1931), a corporate-income-tax case). Taxes on a trust, in contrast, are rationally related to the taxing state's values if the taxes are "apportioned to the value of the equitable interest" held by an in-state beneficiary. *See, e.g.*, *McCulloch*, 290 P.2d at 416 n.5; *Stewart*, 12 A.2d at 446 (same). That test is satisfied here, because North Carolina has taxed the Trust only on income that was earned "for the benefit of a resident of this State." N.C. Gen. Stat. § 105-160.2 (2017).

intensified recently, culminating in three decisions in the past five years—including a case in which the State of Minnesota now seeks certiorari. *See Fielding*, 916 N.W.2d 323, *petition for cert. filed*, No. 18-664 (Nov. 15, 2018). Without this Court's intervention, the direct split here will only worsen.

Thus, regardless of who is right on the merits, the Court should grant the petition to resolve the split that the petition describes.

* * *

In sum, the Trust's brief only confirms that the Department's petition should be granted. The Trust's reliance on factual minutiae to explain away the direct split does not succeed. Its attempt to manufacture a vehicle problem highlights why this case is a clean and timely vehicle to address the question presented. Finally, the Trust's *Pennoyer*-era theory for why it should win on the merits only demonstrates the need for this Court to modernize its trust-taxation jurisprudence.

The Due Process Clause should not have different meanings across nine states, especially when billions of dollars in state-tax revenue hang in the balance. It is time for this Court to resolve this conflict.

CONCLUSION

The petition should be granted.

Respectfully submitted,

JOSHUA H. STEIN
Attorney General

MATTHEW W. SAWCHAK
Solicitor General
Counsel of Record
JAMES W. DOGGETT
Deputy Solicitor General
NORTH CAROLINA
DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400

ROBERT F. ORR
ROBERT F. ORR, PLLC
3434 Edwards Mill Rd.
Suite 112-372
Raleigh, NC 27612
(919) 608-5335

ANDREW H. ERTESCHIK
SAAD GUL
JOHN M. DURNOVICH
NATHANIEL C. ZINKOW
POYNER SPRUILL LLP
Post Office Box 1801
Raleigh, NC 27602
(919) 783-2895

December 14, 2018

No. 18-457

In The
Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST,

Respondent.

On Writ Of Certiorari To The Supreme Court Of North Carolina

JOINT APPENDIX

MATTHEW W. SAWCHAK
Solicitor General
NORTH CAROLINA
DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400
msawchak@ncdoj.gov

Counsel of Record for Petitioner

DAVID O'NEIL
DEBEVOISE & PLIMPTON
801 Pennsylvania Avenue, N.W.
Washington, DC 20004
(202) 383-8000
daoneil@debevoise.com

Counsel of Record for Respondent

Petition For A Writ Of Certiorari Filed October 9, 2018
Certiorari Granted January 11, 2019

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

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The Kimberly Rice Kaestner Trust VS N.C. Dep't of Revenue
Case Number:
2012CVS8740

Case County:
WAKE

Judge:
Gregory P. McGuire

1	06/20/2012	(1) Complaint	Complaint by Plaintiff: The Kimberley Rice Kaestner Trust
11	09/07/2012	(11) Brief in Support (except Summary Jmnt Motion)	Defendant's Motion to Dismiss & Brief in Support of Motion to Dismiss by Defendant:N.C. Dept of Revenue
15	10/31/2012	(15) Other Brief	Response in Opposition to Motion to Dismiss by Plaintiff:The Kimberly Rice Kaestner Trust
17	11/13/2012	(17) Brief in Support (except Summary Jmnt Motion)	Defendant's Reply Brief In Support of Motion to Dismiss by Defendant:N.C. Dept of Revenue
21	02/11/2013	(21) Order and Opinion	Opinion and Order on Defendant's MTD by Court:Court

24	06/13/2013	(24) Answer to Complaint	Answer by Defendant:N.C. Dept of Revenue
37	07/02/2014	(37) Motion for Summary Judgment	Plaintiffs Motion for Summary Judgment by Plaintiff:The Kimberly Rice Kaestner Trust
38	07/02/2014	(38) Motion for Summary Judgment	Memorandum of Law in Support of Plaintiff's Motion for Summary Judgment by Plaintiff:The Kimberly Rice Kaestner Trust
44	09/02/2014	(44) Motion for Summary Judgment	Defendant's Motion for Summary Judgment by Defendant:N.C. Dept of Revenue
45	09/02/2014	(45) Other Brief	Brief in Support of Defendant's SJ Motion & Response to Plaintiff's Motion by Defendant:N.C. Dep't of Revenue
50	10/01/2014	(50) Other Brief	Response in Opposition to Def.'s Motion for SJ and Reply in Support of Pl.'s Motion for SJ by Plaintiff:The Kimberly Rice Kaestner Trust

51	10/14/2014	(51) Other Motion	Defendant's Reply to Plaintiff's Response and Reply to Motions for Summary Judgment by Defendant:N.C. Dep't of Revenue
54	04/23/2015	(54) Order and Opinion	Opinion and Order on Motions for Summary Judgment by Court:Court
55	05/21/2015	(55) Motion to Stay	Motion to Stay by Defendant:N.C. Dept of Revenue
56	05/22/2015	(56) Notice of Appeal	Notice of Appeal by Defendant:N.C. Dep't of Revenue
57	06/01/2015	(57) Order	Order on Motion to Stay by Court:Court

Relevant Docket Entries of the North Carolina Court of Appeals

Docket Sheet

The Kimberley Rice Kaestner 1992 Fam. Tr. v. NC Dept. of Revenue

Case Number: 15-896

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1 – RECORD
Filed: 08-12-2015 @ 03:46:00
FOR: Defendant-Appellant North Carolina Department of Revenue
BY : Ms. Peggy S. Vincent
N.C. DEPARTMENT OF JUSTICE

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3 – APPELLANT BRIEF
Filed: 10-14-2015 @ 16:54:32
FOR: Defendant-Appellant North Carolina Department of Revenue
BY : Ms. Peggy S. Vincent
N.C. DEPARTMENT OF JUSTICE

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6 – APPELLEE BRIEF
Filed: 12-16-2015 @ 19:42:32
FOR: Plaintiff-Appellee The Kimberley Rice Kaestner 1992 Family Trust
BY : Mr. Thomas D. Myrick
MOORE & VAN ALLEN

8 – APPELLANT BRIEF
Filed: 01-14-2016 @ 17:47:08
FOR: Defendant-Appellant North Carolina Department of Revenue
BY : Ms. Peggy S. Vincent
N.C. DEPARTMENT OF JUSTICE

Relevant Docket Entries of The

SUPREME COURT OF NORTH CAROLINA

Docket Sheet

The Kimberley Rice Kaestner 1992 Family Trust v N.C. Department of Revenue

Case Number: 307PA15-2

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1 – APPLICATION FOR TEMPORARY STAY
(Allowed) – 07-25-2016
Filed: 07-22-2016 @ 16:26:27
FOR: Defendant-Appellant North Carolina Department of Revenue
BY :Ms. Peggy S. Vincent
N.C. DEPARTMENT OF JUSTICE

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2 – PETITION FOR WRIT OF SUPERSEDEAS
(Allowed) – 12-08-2016
Filed: 07-22-2016 @ 16:18:25
FOR: Defendant-Appellant North Carolina Department of Revenue
BY : Ms. Peggy S. Vincent
N.C. DEPARTMENT OF JUSTICE

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4 – PETITION FOR DISCRETIONARY REVIEW
(Allowed) – 12-08-2016
Filed: 08-09-2016 @ 10:44:34
FOR: Defendant-Appellant North Carolina Department of Revenue
BY : Ms. Peggy S. Vincent
N.C. DEPARTMENT OF JUSTICE

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7 – APPELLANT BRIEF
Filed: 03-09-2017 @ 11:42:44
FOR: Defendant-Appellant North Carolina Department of Revenue
BY : Mr. Matthew W. Sawchak
N.C. DEPARTMENT OF JUSTICE

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10 – APPELLEE BRIEF
Filed: 06-12-2017 @ 22:54:37
FOR: Plaintiff-Appellee The Kimberley Rice Kaestner 1992 Family Trust
BY : Mr. Thomas D. Myrick
MOORE & VAN ALLEN

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12 – APPELLANT BRIEF
Filed: 07-13-2017 @ 15:21:53
FOR: Defendant-Appellant North Carolina Department of Revenue
BY : Mr. Matthew W. Sawchak
N.C. DEPARTMENT OF JUSTICE

STATE OF NORTH CAROLINA COUNTY OF WAKE	IN THE GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION 12-CVS-_____
THE KIMBERLY RICE KAESTNER 1992 TRUST, Plaintiff, v. NORTH CAROLINA DEPARTMENT OF REVENUE, Defendant	**COMPLAINT** (Filed Jun. 21, 2012)

Plaintiff, the Kimberly Rice Kaestner 1992 Trust, asserts a complaint against Defendant, the NC Department of Revenue, pursuant to Sections 105-241.17 of the North Carolina General Statutes, and alleges as follows:

SUMMARY OF CLAMS

1. Plaintiff has been forced to pay an unconstitutional tax to the State of North Carolina based solely on the fact that a beneficiary is a resident of the State.

2. Section 105-160.2 of the North Carolina General Statutes imposes a tax on trusts "computed on the amount of the taxable income of the estate or trust that is for the benefit of a resident of this State. . . ." "The

tax computed under the provisions of this Part shall be paid by the fiduciary responsible for administering the estate or trust" *Id.*

3. Plaintiff requested a refund for taxes paid pursuant to Section 105-1602 for the 2005 through 2008 tax periods.

4. Defendant denied Plaintiff's refund request because Plaintiff has a beneficiary who is a North Carolina resident.

5. Section 105-160.2 is unconstitutional on its face and as applied to Plaintiff.

6. Section 105-160.2 violates the United States Constitution because, *inter alia*, it is inconsistent with the due process clause of the Fourteenth Amendment ("Due Process Clause") and the commerce clause found in Article I, § 8, cl. 3 of the United States Constitution. ("Commerce Clause").

7. Section 105-160.2 also violates the North Carolina Constitution because, *inter alia*, it is inconsistent with Section 19 of Article I.

PARTIES

8. Plaintiff is a trust with a situs in New York.

9. Defendant is charged with the administration of tax laws and regulations for the State. Defendant has been, is currently, and will be acting under color of authority and law of the state.

JURISDICTION AND VENUE

10. The Office of Administrative Hearings dismissed Plaintiff's petition because Plaintiff is challenging the constitutionality of a North Carolina tax statute. As a result, this Court has jurisdiction over this action and is the only proper venue. *See* N.C. GEN. STAT. § 105-241.17. Attached as Exhibit A is a copy of the Office of Administrative Hearings Final Decision Order of Dismissal, filed August 22, 2011.

FACTUAL BACKGROUND

11. The Joseph Lee Rice, III Family 1992 Trust (the "Trust") was created under agreement (the "Trust Agreement") dated December 30, 1992 between Joseph Lee Rice III as Settlor (the "Settlor") and William B. Matteson as Trustee (the "Initial Trustee").

12. On the date of the Trust's creation, the primary beneficiaries of the Trust were the Settlor's descendants, none of whom were residents or domiciliaries of North Carolina.

13. On the date of the Trust's creation, both the Settlor and the Initial Trustee were residents and domiciliaries of New York and the Trust was subject to New York income tax.

14. On the date of the Trust's creation, the Trust was a separate tax paying entity, and it continues to be such an entity.

15. The Trust Agreement recites that New York law governs the Trust.

16. In 1995, the Initial Trustee moved to Florida.

17. On December 30, 2002, pursuant to Section 1.2 of the Trust Agreement, the Trust was divided into separate share trusts; one for each of the Settlor's three children, Kimberly Rice Kaestner (formerly Kimberly E. Rice), Daniel Rice and Lee Rice. Kimberly Rice Kaestner was a resident and domiciliary of North Carolina at that time, having moved to North Carolina in 1997.

18. The current beneficiaries of the separate share trust for the benefit of Kimberly Rice Kaestner (i.e., Plaintiff) are Kimberly Rice Kaestner and her three children, all of whom were residents and domiciliaries of North Carolina in the 2005, 2006, 2007 and 2008 tax years.

19. The contingent remainder beneficiaries of the Trust are Daniel Rice (a resident and domiciliary of Virginia), Lee Rice (a resident and domiciliary of New York), the Settlor's Spouse, Franci Blassberg (a resident and domiciliary of New York), and the Settlor's sister, Jere Anne Vockins (a resident and domiciliary of Connecticut).

20. On December 21, 2005 the Initial Trustee resigned as trustee of the Trust (and of each of its separate share trusts including Plaintiff) and the Settlor appointed David Bernstein, who was then and has

continued since then to be a Connecticut resident and domiciliary, as successor Trustee.

21. Between 2005 and 2008, the assets held in Plaintiff consisted of equities, mutual funds and investments in partnerships.

22. Plaintiff filed Form D-407 "Estates and Trusts Income Tax Return" with Defendant in 2005, 2006, 2007 and 2008 and paid the tax allegedly due to North Carolina in full on the income accumulated by Plaintiff and not distributed.

23. From the Trust's creation through and including the 2008 tax period, no distributions were ever made to a North Carolina beneficiary.

PROCEDURAL BACKGROUND

24. Plaintiff filed a claim for a refund of taxes with Defendant for all tax paid for the 2005, 2006, and 2007 tax periods on September 9, 2009, and for the 2008 tax period on October 21, 2009, on the basis that Section 105-160.2 is unconstitutional because, *inter alia*, it violates the Due Process Clause and the Commerce Clause of the U.S. Constitution and Section 19 of Article I of the Constitution of the State of North Carolina.

25. Plaintiff sought refunds for these tax periods in the following amounts:

(a) Tax Period 2005: $79,634.00

(b) Tax Period 2006: $106,637.00

(c) Tax Period 2007: $1,099,660.00

(d) Tax Period 2008: $17,241.00

26. On April 15, 2010, Defendant served Plaintiff with a Notice of Proposed Denial of Refund for the 2005, 2006 and 2007 tax periods.

27. For the 2008 tax period, Defendant is deemed to have denied Plaintiff's refund request on April 21, 2010 because Defendant did not take one of the actions listed in Section 105-241.7(c) within six months of the filing of the claim for refund of taxes.

28. On May 12, 2010, Plaintiff filed an Objection and Request for Departmental Review for tax years 2005, 2006, 2007 and 2008.

29. On December 14, 2010, Plaintiff's representatives and Defendant had a telephone conference as required by Section 105-241.13(b).

30. On February 11, 2011, Defendant served Plaintiff with a Notice of Final Determination for tax years 2005, 2006, 2007 and 2008 (the "Final Determination").

31. The Final Determination states the following as the basis for the Defendant's denial of the Plaintiff's claim for a refund:

> In the California case, *McCulloch v. Franchise Tax Board*, 61 Cal. 2d. 186, 390 P.2d 412 (1964), it was found that the state of the trust beneficiary's residence may properly tax the trust on income payable in the future to the

> beneficiary. Although the income is retained by the trust, the state provides protection incident to the beneficiary's eventual enjoyment of accumulated income. As an official of the executive branch of government, the Secretary of Revenue lacks the authority to determine the constitutionality of legislative acts. The Department has determined that the denial of taxpayer's claim for refund is in accordance with North Carolina statutes and case law and is therefore correct.

32. Plaintiff commenced a contested case before the Office of Administrative Hearings on March 28, 2011.

33. On May 2, 2011, Defendant moved to dismiss the contested case for lack of jurisdiction.

34. On August 22, 2011, the Office of Administrative Hearings granted Defendant's motion and dismissed the contested case petition for lack of jurisdiction because the sole issue was the constitutionality of a statute.

35. In Compliance with N.C.G.S. § 105-241.17, Plaintiff commences this action within two years of the dismissal by the Office of Administrative Hearings and there are no taxes, penalties or interest outstanding.

FIRST CLAIM FOR RELIEF
(Violation of the Due Process Clause of the U.S. Constitution)

36. The allegations of paragraphs 1 through 35 are incorporated herein by reference.

37. Defendant improperly assessed taxes against Plaintiff because Plaintiff does not have minimum contacts with the State of North Carolina:

(a) the trustees were never residents of North Carolina;

(b) the situs of the trust is located outside of North Carolina;

(c) the trust property is located outside of North Carolina;

(d) assets of the trust upon which tax has been assessed have not been distributed to any beneficiary inside North Carolina; and

(e) the Settlor was never a resident of North Carolina.

38. Plaintiff has done nothing to avail itself of the benefits and protections of North Carolina.

39. Defendant's improper assessments deprived Plaintiff of property.

40. Therefore, Section 105-160.2 and its application to Plaintiff are unconstitutional.

SECOND CLAIM FOR RELIEF
(Violation of the Commerce Clause of the U.S. Constitution)

41. The allegations of paragraphs 1 through 40 are incorporated herein by reference.

42. Defendant improperly assessed taxes against Plaintiff because the assessed taxes pursuant to 105-160.2 violate the commerce clause in that:

(a) the tax is not applied to an activity with a substantial nexus with the taxing state;

(b) the tax is not fairly apportioned among all jurisdictions with which the activity has a nexus;

(c) the tax discriminates against interstate commerce; and

(d) the tax is not fair relative to the services provided by the State.

43. There are no minimum contacts between Plaintiff and the State of North Carolina because:

(a) the trustees were never residents of North Carolina;

(b) the situs of the trust is located outside of North Carolina;

(c) the trust property is located outside of North Carolina;

(d) the assets of the trust upon which tax has been assessed have not been distributed to any beneficiary inside North Carolina; and

(e) Settlor was never a resident of North Carolina.

44. Defendant's improper assessments deprived Plaintiff of property.

45. Therefore Section 105-160.2 and its application to Plaintiff are unconstitutional.

THIRD CLAIM FOR RELIEF
(Violation of the North Carolina Constitution)

46. The allegations of paragraphs 1 through 45 are incorporated herein by reference.

47. Defendant improperly assessed taxes against Plaintiff.

48. These assessments deprived Plaintiff of property without due process and in violation of the Commerce Clause of the United States Constitution.

49. These deprivations are a violation of Section 19 of the North Carolina Constitution.

WHEREFORE, Plaintiff respectfully prays that this Court:

1. Find that Section 105-160.2 is unconstitutional because it violates the Due Process Clause and the Commerce Clause of the U.S. Constitution and Section 19 of the North Carolina Constitution.

2. Require Defendant to refund all taxes, penalties and interest previously paid by Plaintiff pursuant

to Section 105-160.2 for tax periods 2005, 2006, 2007 and 2008, together with interest as required by law.

3. Enjoin Defendant from enforcing any assessments issued pursuant to Section 105-160.2, or to issue future assessments based on this statute against Plaintiff.

4. Award Plaintiff such other and further relief as this Court deems just and proper.

This 20th day of June, 2012.

Respectfully submitted,

/s/ Thomas D. Myrick
Thomas D. Myrick
N.C. State Bar No. 12645
Neil T. Bloomfield
N.C. State Bar No. 37800

MOORE & VAN ALLEN, PLLC
100 North Tryon Street – Floor 47
Charlotte, North Carolina 28202
Telephone: (704) 331-1000
Facsimile: (704) 331-1159

ATTORNEYS FOR PLAINTIFF

STATE OF NORTH CAROLINA COUNTY OF WAKE	IN THE GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION 12 CVS 8740
THE KIMBERLY RICE KAESTNER 1992 TRUST, Plaintiff, v. NORTH CAROLINA DEPARTMENT OF REVENUE, Defendant	**OPINION AND ORDER ON DEFENDANT'S MOTION TO DISMISS** (Filed Feb. 11, 2013)

THIS MATTER comes before the court on Defendant North Carolina Department of Revenue's Motion to Dismiss ("Motion") Plaintiff's various claims pursuant to Rules 12(b)(1), (2) and (6) of the North Carolina Rules of Civil Procedure ("Rule(s)"); and

THE COURT, having reviewed the Motion, briefs in support and in opposition thereof and other appropriate matters of record, FINDS, CONCLUDES and ORDERS that the Motion is GRANTED in part, and DENIED in part, for the reasons stated herein.

Moore & Van Allen, P.L.L.C. by Thomas D. Myrick, Esq. and Neil T. Bloomfield, Esq. for Plaintiff.

North Carolina Department of Revenue by Kay Linn Miller Hobart, Esq. and Peggy Vincent, Esq. for Defendant.

Procedural Posture

[1] The Kimberly Rice Kaestner 1992 Trust brings the present action and asks this court to determine that as it relates to this action, North Carolina General Statute § 105-160.2 (hereinafter, references to North Carolina General Statutes will be to "G.S.") violates the Due Process Clause and the Commerce Clause of the United States Constitution and Section 19 of the North Carolina Constitution. Plaintiff seeks a refund of all taxes, penalties and interest paid by it pursuant to G.S. 105-160.2 for the tax years 2005 through 2008 ("Constitutional Claims"). Plaintiff further seeks to enjoin Defendant from enforcing any assessments issued pursuant to G.S. 105-160.2 and from issuing future assessments against Plaintiff based on the same statute ("Injunctive Relief").

Factual Background

[2] G.S. 105-160.2 provides, in pertinent part, that the North Carolina Department of Revenue may assess an income tax on the portion of a foreign trust's retained income that is for the benefit of a North Carolina resident.

[3] Plaintiff is a wholly foreign trust. Neither Plaintiff's trustees nor its settlor have ever resided in North Carolina. Plaintiff's situs is located outside North Carolina. All property owned by Plaintiff is located outside of North Carolina. Plaintiff has never made a distribution to any beneficiary residing in North Carolina. Plaintiff derives no income within

North Carolina or from North Carolina sources. It apparently is uncontested that Plaintiff's sole connection to North Carolina is the presence of Plaintiff's current beneficiaries, Mrs. Kimberly Rice Kaestner and her three children ("Beneficiaries") within the State.

[4] Plaintiff operates as a discretionary trust, with the Trustee having absolute discretion as to whether distributions are made to the Beneficiaries. None of the Beneficiaries may make a demand on Plaintiff for a distribution nor do the Beneficiaries have any rights as to Plaintiff's assets.

[5] Plaintiff paid taxes to Defendant pursuant to G.S. 105-160.2 for the calendar years 2005 through 2008 based solely on the presence of the Beneficiaries within North Carolina.

[6]. In 2009, Plaintiff filed claims with Defendant for a refund of all taxes paid pursuant to G.S. 105-160.2 for the tax years 2005 through 2008. Those claims were denied by Defendant.

[7] In 2010, Plaintiff filed an Objection and Request for Departmental Review based on Defendant's denial of Plaintiff's 2009 claims. Defendant again denied Plaintiff's claims.

[8] In 2011, Plaintiff commenced an action before the Office of Administrative Hearings seeking the same relief it seeks here. The Office of Administrative Hearings dismissed Plaintiff's action based on lack of jurisdiction because the sole issue for determination was the constitutionality of G.S. 105-160.2.

[9] Plaintiff then filed its civil action with this court pursuant to G.S. 105-241.17. All other requirements of G.S. 105-241.17 have been satisfied, and this case is properly before the court.

Discussion

[10] Plaintiff contends the taxation scheme outlined in G.S. 105-160.2 is unconstitutional under the Due Process Clause of the United States Constitution ("Due Process Clause") because the mere presence of a beneficiary within the state is not a sufficiently substantial connection with North Carolina to justify the state imposing a tax on Plaintiff's retained income. Plaintiff further argues that G.S. 105-160.2 is unconstitutional under the Due Process Clause because there is no rational relationship between the tax imposed on Plaintiff by G.S. 105-160.2 and any benefit provided to Plaintiff by the state.

[11] Plaintiff also argues that G.S. 105-160.2 is unconstitutional under the Commerce Clause of the United States Constitution ("Commerce Clause") because: (a) the tax is not applied to an activity with a substantial nexus to North Carolina; (b) the tax is not fairly apportioned; (c) the tax discriminates against interstate commerce and (d) the tax is not fair relative to the services provided to Plaintiff by North Carolina.

[12] Lastly, Plaintiff contends that G.S. 105-160.2 is unconstitutional under Section 19 of the North Carolina Constitution ("Section 19") because the

statute deprived Plaintiff of property without due process of law and in violation of the Commerce Clause.

[13] The Motion seeks dismissal of Plaintiff's Constitutional Claims pursuant to Rule 12(b)(6) and dismissal of the Injunctive Relief sought by Plaintiff pursuant to Rules 12(b)(1), (2) and (6). In support of the Motion, Defendant argues that Plaintiff's Constitutional Claims fail as a matter of law because G.S. 105-160.2, on its face, conforms to the Due Process Clause, the Commerce Clause and Section 19. Plaintiff also submits that the Injunctive Relief sought by Plaintiff is barred by sovereign immunity and G.S. 105-241.19.

[14] Turning first to Plaintiff's prayer for Injunctive Relief, the court FINDS and CONCLUDES that G.S. 105-241.19 sets out the exclusive remedies for disputing the denial of a requested refund and expressly prohibits actions for injunctive relief to prevent the collection of a tax. Therefore, Plaintiff cannot pursue Injunctive Relief in this action, and the Motion should be GRANTED as to the Injunctive Relief sought by Plaintiff. Plaintiff's Injunctive Relief claim should be DISMISSED.

[15] Turning next to Plaintiff's Constitutional Claims, the court notes that dismissal of a claim pursuant to Rule 12(b)(6) is appropriate "when the complaint on its face reveals that no law supports plaintiff's claim. . . ." *Jackson v. Bumgardner*, 318 N.C. 172, 175 (1986). Conversely, a claim should not be dismissed pursuant to Rule 12(b)(6) unless, "it appears

beyond a reasonable doubt that the plaintiff could not prove any set of facts in support of his claim that would entitle him to relief." *Sutton v. Duke*, 277 N.C. 94, 108 (1970). A party may move to dismiss under Rule 12(b)(6) to test the legal sufficiency of a complaint asserting constitutional issues. *N.C. E. Mun. Power v. Wake Cnty.*, 100 N.C. App. 693 (1990).

[16] It appears to the court that this issue is a matter of first impression in North Carolina. This fact is apparently uncontested by Defendant. There is no affirmative case law in North Carolina upholding the constitutionality of G.S. 105-160.2 that bars Plaintiff's Constitutional Claims. Further, neither the court nor the parties have found any binding law from other sources that upholds a taxation scheme similar to G.S. 105-160.2. The cases cited by Defendant in support of the Motion are not entirely analogous, either legally or factually, to the present action and are, for the most part, from other jurisdictions. Therefore, the court has no basis to conclude that Plaintiff's Constitutional Claims, on their face, must fail as a matter of law.

[17] In addition, Plaintiff cites to a number of similar cases that support its contention that G.S. 105-160.2 is unconstitutional. It appears to the court that there is at least a colorable argument that North Carolina's imposition of a tax on a foreign trust based solely on the presence of a beneficiary in the state does not conform with the Due Process Clause, the Commerce Clause or Section 19. In so finding, the court does not pass judgment on the ultimate constitutionality of G.S. 105-160.2. The court only concludes that

there is some basis in the law to support Plaintiff's claims.

[18] The Motion now before the court has a somewhat unusual posture. To grant the Motion, the court would have to conclude, as a matter of law, that G.S. 105-160.2 conforms to the Due Process Clause, the Commerce Clause and Section 19. Given that there appear to be no remaining factual issues here, and the fact that a Rule 12(b)(6) motion may be used to test the legal sufficiency of a constitutional claim, the court might appropriately determine now the ultimate issue of the constitutionality of G.S. 105-160.2 in the context of this action. However, at the hearing on the Motion, counsel for Defendant contended that this court should not determine the present action on its merits and instead base its decision solely on the narrow legal issue of whether Plaintiff has failed to state a claim upon which relief may be granted. This apparently was on the theory that there may be relevant facts not currently of record that could impact the ultimate outcome of this matter. Upon due consideration, the court declines to reach the ultimate constitutionality of G.S. 105-160.2 at this time, and instead limits itself to determining whether Plaintiff's claims fail as a matter of law.

[19] Based on the foregoing, the court CONCLUDES that Plaintiff's Constitutional Claims are sufficient to withstand the Motion, and the Motion therefore should be DENIED as to Plaintiff's Constitutional Claims.

THEREFORE, it hereby is ORDERED that:

[20] As to Plaintiff's claim for Injunctive Relief, the Motion is GRANTED and Plaintiff's Injunctive Relief claim is DISMISSED.

[21] As to Plaintiff's Constitutional Claims, the Motion is DENIED.

This the 11th day of February, 2013.

/s/ John R. Jolly, Jr.
John R. Jolly, Jr.
Chief Special Superior Court Judge
for Complex Business Cases

STATE OF NORTH CAROLINA **COUNTY OF WAKE**	**IN THE GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION 12 CVS 8740**
THE KIMBERLY RICE KAESTNER 1992 FAMILY TRUST, **Plaintiff,** **v.** **NORTH CAROLINA DEPARTMENT OF REVENUE,** **Defendant.**	**ANSWER** (Filed Jun. 17, 2013)

NOW COMES the Defendant, THE NORTH CAROLINA DEPARTMENT OF REVENUE ("Department"), and hereby responds to the Complaint of the Plaintiff, THE KIMBERLY RICE KAESTNER 1992 FAMILY TRUST ("Trust") and hereby alleges and says:

1. Denied.

2. The allegations of paragraph 2 are legal conclusions to which no response is necessary or required. To the extent a response is required, the allegations of paragraph 2 are denied.

3. Admitted.

4. The terms of the refund denial letter from the Department speak for themselves. Except as

specifically admitted herein, the allegations of paragraph 4 are denied.

5. Denied.

6. Denied.

7. Denied.

8. The allegations of paragraph 8 are ambiguous as "situs" has numerous legal definitions. Further, the allegations of paragraph 8 are legal conclusions to which no response is necessary or required. To the extent a response is required, the allegations of paragraph 8 are denied.

9. Admitted.

10. Admitted.

11. Admitted

12. Admitted that on the date of the trust's creation, the primary beneficiaries of the trust were the settlor's descendants. The Department lacks sufficient information to admit or deny the remaining allegations contained in paragraph 12. Therefore, the remaining allegations are denied.

13. The Department lacks sufficient information to admit or deny the allegations contained in paragraph 13. Therefore, the allegations are denied.

14. The allegations of paragraph 14 are legal conclusions to which no response is necessary or

required. To the extent a response is required, the allegations of paragraph 14 are denied.

15. Admitted.

16. The Department lacks sufficient information to admit or deny the allegations contained in paragraph 16. Therefore, the allegations are denied.

17. Admitted that pursuant to Section 1.2 of the Trust Agreement, the trust was divided into separate share trusts; one for each of the settlor's three children, one of which was Kimberly Rice Kaestner, who was a resident and domiciliary of North Carolina at that time. As to the remaining allegations of paragraph 17, the Department lacks sufficient information to admit or deny them. Therefore, the remaining allegations in paragraph 17 are denied.

18. Admitted.

19. The Department lacks sufficient information to admit or deny the allegations contained in paragraph 19. Therefore, the allegations are denied.

20. The Department lacks sufficient information to admit or deny the allegations contained in paragraph 20. Therefore, the allegations are denied.

21. The Department lacks sufficient information to admit or deny the allegations contained in paragraph 21. Therefore, the allegations are denied.

22. Denied that the Trust filed Form D-407 "Estates and Trusts Income Tax Return" with the Department in 2005, 2006, 2007 and 2008. The Trust filed

returns for tax years 2005, 2006 and 2007 in 2008, and filed a return for tax year 2008 in 2009. The Trust paid the tax it shows on its returns for tax years 2005 through 2008. However, since these returns were not audited, the Department has no information as to their correctness. The Trust has made no filings nor paid any taxes to North Carolina for any tax years after 2008. Except as admitted herein, any other allegations of paragraph 22 are denied.

23. The Department lacks sufficient information to admit or deny the allegations contained in paragraph 23. Therefore, the allegations are denied.

24. Admitted that the Trust filed a claim for a refund for tax years 2005, 2006, and 2007 on September 9, 2009. Further admitted that the Trust filed a claim for a refund for tax year 2008 by letter dated October 20, 2009. The Department lacks sufficient information as to the date of receipt of the 2008 claim for refund, and therefore, that allegation as to its filing date is denied. Admitted that the claim for refund was based on the Trust's assertion that North Carolina General Statute § 105-160.2 is unconstitutional because it allegedly violates the Due Process Clause and the Commerce Clause of the U.S. Constitution and Section 19 of Article 1 [sic] of the Constitution of the State of North Carolina.

25. Admitted.

26. Admitted.

27. The Department lacks sufficient information as to the date the Trust filed its claim for refund for the 2008 tax year to enable the Department to admit or deny the allegations contained in paragraph 27. Therefore, the allegations are denied.

28. Admitted that the Trust filed an Objection and Request for Departmental Review for tax years 2005, 2006, 2007 and 2008 ("Objections"). However, the Department's file stamped receipt date reflects that the Objections were filed May 18, 2010. Except as herein admitted, the remaining allegations of paragraph 28 are denied.

29. Admitted.

30. Admitted.

31. The terms of the Notice of Final Determination Letter from the Department speak for themselves. Except as specifically admitted herein, the allegations of paragraph 31 are denied.

32. Admitted.

33. Denied. The Department filed its motion to dismiss on May 4, 2011.

34. Admitted.

35. Admitted that the Trust filed this action in compliance with North Carolina General Statute § 105-241.17. However, the Department lacks sufficient knowledge of taxes, penalties and interest that may be due for tax years 2009 through 2012 since no North Carolina return was filed for those years.

Therefore, the allegation as to no amounts being due and owing is denied.

36. The Department realleges and incorporates its responses to paragraphs 1 through 35 by reference.

37. Denied.

38. Denied.

39. Denied.

40. Denied.

41. The Department realleges and incorporates its responses to paragraphs 1 through 40 by reference.

42. Denied.

43. Denied.

44. Denied.

45. Denied.

46. The Department realleges and incorporates its responses to paragraphs 1 through 45 by reference.

47. Denied.

48. Denied.

49. Denied.

AFFIRMATIVE DEFENSES

1. Plaintiff's requested injunctive relief is expressly barred by statute and principles of sovereign immunity.

2. N.C. Gen. Stat. § 105 241.19 provides:

> The remedies in G.S. 105 241.11 through G.S. 105 241.18 set out the exclusive remedies for disputing the denial of a requested refund, a taxpayer's liability for a tax, or the constitutionality of a tax statute. Any other action is barred. Neither an action for declaratory judgment, an action for injunction to prevent the collection of a tax, nor any other action is allowed.

3. By statute and law, the Plaintiff is not entitled to injunctive relief nor to a declaratory judgment.

WHEREFORE, Defendant respectfully prays the Court as follows:

1. Deny all relief requested in the Complaint;

2. Tax all costs of this action and attorneys' fees against the Plaintiff; and

3. Grant such other relief as the Court deems appropriate.

Respectfully submitted, this the 13th day of June, 2013.

ROY COOPER
Attorney General

/s/ Kay Linn Miller Hobart
Special Deputy Attorney General
State Bar No. 16746
khobart@ncdoj.gov

/s/ Peggy S. Vincent
Assistant Attorney General
N.C. State Bar No. 16088
Pvincent@ncdoj.gov
Attorneys for Defendant
N.C. Attorney General's Office
P.O. Box 629
Raleigh, N.C. 27602-0629
Telephone: (919) 716-6550
Fax (919) 715-3550

[Certificate Of Service Omitted]

STATE OF NORTH CAROLINA COUNTY OF WAKE	IN THE GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION 12-CVS-8740
THE KIMBERLY RICE KAESTNER 1992 FAMILY TRUST, Plaintiff, v. NORTH CAROLINA DEPARTMENT OF REVENUE, Defendant.	**PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT** (Filed Jul. 8, 2014)

Pursuant to Rule 56 of the North Carolina Rules of Civil Procedure, Plaintiff, The Kimberley Rice Kaestner 1992 Family Trust ("Plaintiff Trust"), by and through counsel, hereby respectfully moves the Court for Summary Judgment in its favor on all claims in this action. Plaintiff Trust submits that the pleadings, depositions, answers to interrogatories, affidavits, and applicable law show there is no genuine issue of material fact warranting a trial of this action, and that Plaintiff Trust is entitled to judgment as a matter of law. In compliance with this Court's Case Management Order dated October 11, 2014, Plaintiff Trust notified Defendant of this motion. Defendant opposes the motion and wishes to be heard.

In support of this motion, Plaintiff Trust submits contemporaneously herewith its Memorandum of Law in Support of Plaintiff Trust's Motion for Summary Judgment and the Affidavit of David H. Bernstein, Plaintiff Trust's trustee, which show, in particular, that

1. From 2005 through 2008, Defendant annually taxed Plaintiff Trust pursuant to N.C. Gen. Stat. § 105-160.2 ("Section 105-160.2").
2. On June 21, 2012, Plaintiff Trust filed its Complaint alleging that Section 105-160.2 is unconstitutional as it violates the Due Process Clause of the U.S. Constitution, the Commerce Clause of the U.S. Constitution, and Section 19 Article I of the North Carolina Constitution.
3. Plaintiff Trust paid taxes to the State of North Carolina in an amount exceeding $1.3 million dollars [sic] for the years 2005 through 2008.
4. It is undisputed that Plaintiff Trust was established, operated, and governed by laws outside of the state of North Carolina by a non-resident settlor at a time when none of the beneficiaries were residents or domiciliaries of North Carolina, and that it held and managed all of its assets outside of North Carolina, was overseen by a nonresident trustee, and did not make any distribution to any North Carolina beneficiary.
5. Plaintiff Trust did not have minimum contacts with the State of North Carolina and, therefore, the tax on Plaintiff Trust violates the Due Process Clause and Section 19 Article I of the North Carolina Constitution.

6. Plaintiff Trust's activities did not have a substantial nexus to North Carolina, and therefore, the tax on Plaintiff Trust violates the Commerce Clause.

7. As a result, Plaintiff Trust is entitled to a full refund of the taxes paid for the period of 2005 through 2008.

WHEREFORE, Plaintiff Trust prays the Court for an Order granting its motion for summary judgment, declaring Section 105-160.2 unconstitutional and ordering Defendant to refund all taxes and penalties paid by Plaintiff Trust pursuant to Section 105-160.2, with interest.

This 2nd day of July, 2014.

Respectfully submitted,

/s/ Neil T. Bloomfield
Thomas D. Myrick
N.C. State Bar No. 12645
Neil T. Bloomfield
N.C. State Bar No. 37800

MOORE & VAN ALLEN, PLLC
100 North Tryon Street – Floor 47
Charlotte, North Carolina 28202
Telephone: (704) 331-1000
Facsimile: (704) 331-1159

ATTORNEYS FOR PLAINTIFF

[Certificate Of Service Omitted]

STATE OF NORTH CAROLINA COUNTY OF WAKE	IN THE GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION 12-CVS-8740
THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST, Plaintiff, v. NORTH CAROLINA DEPARTMENT OF REVENUE, Defendant.	**AFFIDAVIT OF DAVID H. BERNSTEIN** (Filed Jun. 8, 2014)

I, David H. Bernstein, being duly sworn, depose and say:

1. I am over eighteen (18) years of age, am competent to testify, and have personal knowledge of the matters contained herein.

2. I was, and remain, the trustee of The Kimberley Rice Kaestner 1992 Family Trust (the "Plaintiff Trust") from 2005 and through all times relevant to this action.

3. The Joseph Lee Rice, III Family 1992 Trust (the "Family Trust") was created under an agreement dated December 30, 1992 (the "Trust Agreement") between Joseph Lee Rice III as settlor (the "Settlor") and

William B. Matteson as trustee (the "Initial Trustee"). Attached as Exhibit A is a true and correct copy of the Trust Agreement.

4. The Family Trust was created in New York, and the Trust was and is governed by New York law.

5. At the Family Trust's creation:

a. The Settlor was a resident and domiciliary of New York;

b. The Initial Trustee was a resident and domiciliary of New York;

c. The primary beneficiaries of the Family Trust were the Settlor's descendants, none of whom were residents or domiciliaries of North Carolina;

d. The contingent beneficiaries of the Family Trust were the Settlor's spouse and sister, neither of whom were residents or domiciliaries of North Carolina;

e. All of the assets contributed to the Family Trust were located outside of North Carolina; and

f. The Family Trust was a separate tax paying entity subject to New York income tax.

6. In 1995, the Initial Trustee moved to Florida.

7. On December 30, 2002, pursuant to Section 1.2 of the Trust Agreement, the Family Trust was divided into separate share trusts, one for each of the

Settlor's three children, one of whom is Kimberley Rice Kaestner (formerly Kimberley E. Rice). This is the Kimberley Rice Kaestner 1992 Family Trust ("Plaintiff Trust").

8. At the time the Family Trust was divided into separate share trusts, Kimberley Rice Kaestner was a resident and domiciliary of North Carolina, having moved to North Carolina in 1997, almost five years after the Family Trust's creation.

9. The separate share trusts are administered by the trustee under the terms of the Trust Agreement (Exhibit A, Art. 1, § 1.2.)

10. The current beneficiaries of the separate share trust for the benefit of Kimberley Rice Kaestner are Kimberley Rice Kaestner and her three children, all of whom were residents and domiciliaries of North Carolina in the tax years at issue.

11. The contingent remainder beneficiaries of the Plaintiff Trust, none of whom are North Carolina residents, are the Settlor's other two children (both of whom are residents and domiciliaries of New York), the Settlor's spouse (who also is a resident and domiciliary of New York), and the Settlor's sister (who is a resident and domiciliary of Connecticut).

12. The Family Trust, consisting of the three separate share trusts, is an irrevocable *inter vivos* trust (Exhibit A, Art. 10.)

13. In 2005, the Initial Trustee resigned, at which time the Settlor appointed me to serve as

trustee (the "Trustee"). When appointed I was a Connecticut resident and domiciliary and remain so today.

14. Between 2005 and 2008, the assets held in the Plaintiff Trust consisted of equities, mutual funds, and investments in partnerships. The custodian for these assets was State Street Bank (formerly Investors Bank & Trust), located in Boston, Massachusetts. Later, I changed the custodian to Cambridge Appleton Trust, also located in Boston, Massachusetts. Other ownership documents related to assets held in the Plaintiff Trust were located at my offices at Debevoise & Plimpton LLP, in New York, New York. The financial books and records of the Plaintiff Trust were kept at the offices of Eisner Amper LLP, in New York, New York, and the legal records of the Plaintiff Trust were maintained at my offices in New York, New York. Eisner Amper LLP has prepared all the tax returns for the Plaintiff Trust in New York, New York. Eisner Amper LLP and Debevoise & Plimpton LLP prepared the trust accountings in New York, New York.

15. None of the Plaintiff Trust's assets was located in North Carolina, and none of the Plaintiff Trust's income was derived directly from a North Carolina source. The Plaintiff Trust owned no real or personal property located in North Carolina. In 2005, one of the investments of the Family Trust was a partnership interest in the DE Shaw Composite Fund, LLC. The Family Trust held a 0.0827% non-managing member interest in this fund. This fund, in turn, invested in other investments, through which the Family Trust incurred a $0.11 indirect loss attributable to an

unknown North Carolina source. One-third of this loss was attributed to Plaintiff Trust in the amount of approximately $0.04. In 2007, one of the investments of the Rice Family Investors (KER) ("KER Investors"), an entity wholly owned by Plaintiff Trust, was a partnership interest in Magnitude U.S. Partners Fund. KER Investors held a 0.6846% non-managing member interest in that fund. That fund, in turn, invested in other investments, through which KER Investors incurred an indirect $2.10 net loss attributable to an unknown North Carolina source.

16. The beneficiaries have no right to the assets or income of the Plaintiff Trust, as distributions are made at the sole discretion of the Trustee. (Exhibit A, Art. 1, § 1.2(a).) The beneficiaries have no right to control the investment of the Plaintiff Trust assets, and I did not take any direction or accept any recommendation from the beneficiaries concerning my investment decisions. To the contrary, to assist me with investment decisions and allocations, I consulted solely with Rocaton Investment Advisors, LLC, a company located in Norwalk, Connecticut. I had complete discretion to make all investment decisions on my own, taking into account Rocaton's recommendations, and I exercised that discretion without any input from the beneficiaries.

17. From the Trust's creation through and including the 2008 tax period, no distribution was made to a North Carolina beneficiary.

18. In 2009, the Plaintiff Trust was decanted with a significant portion of its assets transferred into the KER Family Trust.

19. The Plaintiff Trust paid taxes to North Carolina on all of its income from 2005 to 2008.

20. Over these four tax years, the Plaintiff Trust paid to North Carolina taxes in an amount exceeding $1.3 million.

21. None of the Plaintiff Trust's income taxed by North Carolina was distributed to anyone anywhere, let alone to any beneficiary in North Carolina.

22. The Plaintiff Trust sought refunds on the taxes paid in the following amounts:

a. $79,634.00 for the 2005 tax year;

b. $106,637.00 for the 2006 tax year;

c. $1,099,660.00 for the 2007 tax year,

d. $17,241.00 for the 2008 tax year.

23. The Department denied the Plaintiff Trust's request for a refund on February 11, 2011.

24. During discovery in this matter the Plaintiff Trust produced records of the Family Trust and of the Plaintiff Trust. The records included: accountings, documents evidencing investment decisions, and communications with the Family Trust's and Plaintiff Trust's accountants and investment advisors. The records also included records of my limited contacts with the beneficiaries, none of which occurred in North Carolina.

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Dated: July 2, 2014

/s/ David H. Bernstein
David H. Bernstein

SWORN to and subscribed before me.

This 2nd day of July, 2014

/s/ Susan Bange Avram
Notary Public for the State
of New York

My Commission Expires: 7/31/2019

[NOTARY STAMP]

[Certificate Of Service Omitted]

EXHIBIT A

THIS AGREEMENT is made and delivered as of the 30th day of December, 1992, between JOSEPH LEE RICE, III, of New York, New York (hereinafter referred to as the "Settlor"), and WILLIAM B. MATTESON of New York, New York (hereinafter and his successor referred to as the "Trustee"), creating the "Joseph Lee Rice, III Family 1992 Trust".

WITNESSETH:

The Settlor hereby assigns, transfers and conveys to the Trustee the property described in Schedule A hereto annexed (hereinafter, together with all additions thereto, referred to as the "Trust Fund"), receipt of which is hereby acknowledged by the Trustee, which is to be held by the Trustee, IN TRUST, for the uses and purposes and on the terms and conditions herein set forth.

ARTICLE FIRST

Distributions

1.1. Initial Term. For a period (the "Initial Term.") commencing on the date of this Agreement (the "Commencement Date"), and expiring on the date ten (10) years from the Commencement Date, the Trustee's duties with respect to the disposition of the income and principal of the Trust Fund shall be as follows:

(a) Distributions of Income. The Trustee may pay or apply so much or all of the net income therefrom to or to the use of such member or members of a class of persons consisting of the Settlor's descendants, whenever born, in such amounts and proportions as the Trustee in the Trustee's absolute discretion may from time to time deem advisable, accumulating any net income not so paid or applied and adding the same to principal.

(b) Distributions of Principal. The Trustee may pay or apply so much or all of the principal thereof to or to the use of such member or members of a class of persons consisting of the Settlor's descendants, whenever born, in such amounts and proportions as the Trustee in the Trustee's absolute discretion may from time to time determine.

1.2. After Initial Term. Upon the termination of the Initial Term, the Trustee shall, after bringing into account any income or principal which may have been paid or applied to or to the use of any child of the Settlor or any of such child's descendants pursuant to Section 1.1 hereof, divide and set apart the Trust Fund into so many equal and separate shares that there shall be one (1) such share for each of the Settlor's children who is then living and one (1) such share for the each of the Settlor's children who is not then living but who shall have left then living descendants (a "Predeceased Child"), and each share set aside for a Predeceased child shall be further divided into subshares, per stirpes, for such Predeceased Child's then living descendants (each of the Settlor's then living children and each of the then living descendants of a Predeceased Child shall be hereinafter individually referred to as a "Beneficiary", and collectively referred to as the "Beneficiaries"). The Trustee's duties with respect to the disposition of the income and principal of each such share or subshare shall be as follows:

(a) Distributions of Income. The Trustee may pay or apply so much or all of the net income therefrom to or to the use of such member or members of a class of

persons consisting of the Beneficiary for whom such share or subshare was set apart and such Beneficiary's descendants, whenever born, in such amounts and proportions as the Trustee in the Trustee's absolute discretion may from time to time deem advisable, accumulating any net income not so paid or applied and adding the same to principal.

(b) Distributions of Principal. The Trustee may pay or apply so much or all of the principal thereof to or to the use of such member or members of a class of persons consisting of the Beneficiary for whom such share or subshare was set apart and such Beneficiary's descendants, whenever born, in such amounts and proportions as the Trustee in the Trustee's absolute discretion may from time to time determine.

(c) Termination. Upon the first event to occur of: (i) a Beneficiary's death or (ii) a Beneficiary's having attained the age of forty (40) years:

(1) The Trustee shall transfer, pay over and deliver the then principal of such Beneficiary's share to such Beneficiary, if such Beneficiary shall then be living.

(2) If such Beneficiary shall not then be living, the Trustee Shall transfer, pay over and distribute the then principal of such Beneficiary's share as follows:

(i) To or in trust for the benefit of such persons and objects, in such amounts, shares and proportions, and either absolutely or upon such lawful trusts,

terms and conditions, as the Beneficiary shall appoint by will; provided, however, that such will makes express reference to this power of appointment; and provided further, however, that such power of appointment shall not be exercisable in favor of such Beneficiary's estate or creditors,

(ii) The Trustee shall subdivide any of such principal not effectively so appointed into subshares, per stirpes, for such Beneficiary's then living descendants, and the Trustee shall hold each such subshare as a separate share in trust under this Agreement for the benefit of the descendant for whom such subshare was set apart and the descendant shall be the Beneficiary of such subshare, which shall be held in trust under this Paragraph (c), subject to all the terms and conditions governing each share of the Trust Fund.

(iii) If such Beneficiary shall not be survived by any descendants, the Trustee shall transfer, pay over and distribute such Beneficiary's share, per stirpes, to the then living descendants of such Beneficiary's nearest ancestor who was a descendant of the Settlor, if any, or if none, then to the Settlor's then living descendants, per stirpes, or if none, then such principal shall be disposed of pursuant to the provisions of Article THIRD of this Agreement.

(iv) If, after taking into account any exemption allocated to any share or subshare distributable under this Subdivision, a generation-skipping transfer tax would become payable on any portion or all of such share or subshare because such distribution would be

to a skip person with respect to the transfer of such property to such person, notwithstanding anything to the contrary hereinabove in this Paragraph (c) provided, the Trustee shall transfer, pay over and distribute such property to or in trust for the benefit of such persons and objects, in such amounts, shares and proportions, and either absolutely or upon such lawful trusts, terms and conditions, as the Beneficiary shall appoint by will, including, without limitation, to the Beneficiary's estate, provided, however, that such will makes express reference to this power of appointment; and in default of such appointment, the Trustee shall transfer, pay over and distribute such property as if the Beneficiary had not been entitled to exercise such power of appointment.

(v) If, pursuant to the preceding provisions of this Paragraph (c), any principal of any share or subshare held under this Article would become distributable to any person for whom a share or subshare is then held in trust under this Agreement, then such principal shall not be delivered to such person but in lien thereof shall be added to the principal of the share or subshare then held in trust for such person, thereafter to follow the disposition of the share to which it is added in all respects as to both income and principal.

(vi) If, pursuant to the preceding provisions of this Paragraph (c), any principal of any share or subshare held under this Article would become distributable to an individual's descendants, per stirpes, then, in making such distribution, the Trustee shall not bring into account any income or principal which may

have been paid or applied to or to the use of any such descendant or such descendant's ancestors or descendants.

1.3. No Distributions of Principal until Termination of Associates IV Limited Partnership. Notwithstanding anything to the contrary hereinabove provided, in no event shall any portion of a limited partnership interest in the Clayton & Dubilier Associates IV Limited Partnership, a Connecticut limited partnership ("Associates IV Limited Partnership"), be transferred, paid over or distributed to the Settlor's descendants.

1.4. Trustee's Discretion for Distributions. (a) If income and principal may be paid or applied to or to the use of such member or members of a class of persons in such amounts and proportions as the Trustee may deem advisable under the provisions of this Article, the Trustee in the Trustee's discretion may pay or apply the same to or to the use of any one member of such class or apportion it for the benefit of various members to the exclusion of other members in such manner as the Trustee may deem advisable.

(b) In exercising the discretion conferred upon the Trustee to use income or principal under any provision of this Article, it shall not be necessary for the Trustee to inquire as to any other income or property of the person for whom income or principal is to be used and the Trustee may consider only the interests of the person or persons for whom it is deemed advisable to use income or principal and not the interests

of any other person who may at any time be or become interested in any trust hereunder.

(c) The Settlor directs the Trustee to consider the Trust Fund and any share or subshare held under this Agreement as a family asset and to be liberal in the exercise of the discretion conferred upon the Trustee and to use income and principal of such trust, even to the entire amount thereof, to meet the needs of the Beneficiaries, including, without limitation, to provide for their health, education and welfare, to purchase or provide a home for them, and to aid them at the time of marriage or in setting up a business, rather than to preserve such principal for the benefit of the persons entitled thereto at the termination of the trust.

ARTICLE SECOND

Termination

The Trustee may at any time in the Trustee's discretion terminate the Trust Fund or any trust hereunder if in the Trustee's judgment it would be inadvisable to continue to hold it in trust; provided, however, that in no event may the Trustee terminate the Trust Fund or any trust hereunder prior to the earlier of (i) the termination and winding up of Associates IV Limited Partnership and (ii) the date the trust created hereunder ceases to be a limited partner of Associates IV Limited Partnership. Upon termination of the Trust Fund during the Initial Term, the Trustee shall transfer, pay over and deliver, free of trust, the assets constituting

the then principal of the Trust Fund or to the Settlor's then living descendants, per stirpes, after bringing into account any income or principal which may have been paid or applied to or to the use of any such descendant or any such descendant's ancestor or descendant pursuant to Section 1.1 hereof. Upon termination of any trust hereunder after the termination of the Initial Term, the Trustee shall transfer, pay over and deliver the then principal of such trust to the person or persons then eligible to receive the income of such trust, in such amounts and proportions as the Trustee in the Trustee's absolute discretion may deem advisable.

ARTICLE THIRD

Contingent Disposition

If, upon the happening of any contingency, any part or all of the principal of the Trust Fund, or any trust under this Agreement, shall be undisposed of pursuant to the provisions of this Agreement other than this Article, then, upon the happening of such contingency, the Trustee shall transfer, pay over and deliver such undisposed of property to the Settlor's Spouse, if she shall then be living, or if she shall not then be living, to the Settlors sister, JERE ANNE VOCKINS, if she shall then be living, or if she shall not then be living, to her descendants who shall then be living, per stirpes.

ARTICLE FOURTH

Distributions to Minors and Incompetents

4.1. Distributions to Minors and Incompetents. Whenever income or principal is to be paid to or used for the benefit of a person under the age of twenty-one (21) years (referred to as a "minor" in this Article) or a person who in the sole judgment of the Trustee is incapable of managing his or her own affairs, the Trustee may make payment of such to property in any or all the following ways:

(a) By paying such property to the parent, guardian or other person having the care and control of such minor for such minor's benefit or to any authorized persons as custodian for such minor under any applicable Gifts to Minors Act, and where permitted under applicable law, with authority to authorize any such custodian to hold such property until the minor attains the age of twenty-one (21) years where permitted; provided, however, that no such payment shall be made to the Settlor or the Settlor's Spouse.

(b) By paying such property to the guardian, committee conservator or other person having the care and control of such incapable person for such incapable person's benefit; provided, however, that no such payment shall be made to the Settlor or the Settlor's Spouse.

(c) By paying directly to such minor or incapable person such sums as the Trustee may deem advisable as an allowance.

(d) By expending such property in such other manner as the Trustee in the Trustee's discretion shall determine will benefit such minor or incapable person.

4.2. Trustee's Discretion; Final Distribution. If principal becomes vested in and payable to a minor, the Trustee may make payment thereof in any of the ways set forth in the preceding Section 4.1 of this Article or may defer payment of any part or all thereof, meanwhile paying or applying to or to the use of such minor so much or all of such principal and of the income therefrom, as the Trustee in the Trustee's discretion may deem advisable. Any income not so expended by the Trustee shall be added to principal. The Trustee shall transfer, pay over and deliver any remaining principal to such minor upon such minor's attaining the age of twenty-one (21) years or to such minor's estate upon death prior to such payment in full.

4.3. Trustee's Discharge. Any payment or distribution authorized in this Article shall be a full discharge to the Trustee with respect thereto.

ARTICLE FIFTH

Investment of Trust Fund

5.1. Investment in Associates IV Limited Partnership. (a) The Trustee shall acquire a limited partnership interest in Associates IV Limited Partnership with cash from the Trust Fund but in no event shall this interest exceed 9.9% of all interests in Associates IV Limited Partnership.

(b) The Trustee initially shall invest the balance of the Trust Fund in an actively managed portfolio pursuant to the provisions of Section 5.2 of this Agreement. In no event shall the Trustee invest any portion of the Trust Fund in securities of any entity relying on Section 3(c)(1) of the Investment Company Act of 1940, as amended, as an exemption from registration under the Investment Company Act of 1940, as amended, other than (i) Associates IV Limited Partnership, (ii) any entity managed or sponsored by Clayton, Dubilier & Rice, Inc. or its successors, or (iii) any entity that acts as the general partner of, or acts in a similar capacity for, such entity.

(c) The Trustee acknowledges that he or she has received a copy of; and understands, a no-action letter, dated November 2, 1992 (the "No-Action Letter"), from the Securities and Exchange Commission addressed to Associates IV Limited Partnership.

5.2. Trustee's Powers. Subject to the above restrictions, the Trustee shall have, with respect to any and all property other than the limited partnership interest in Associates IV Limited Partnership, whether real or personal, at any time held by the Trustee hereunder, including funds held for any person under the age of twenty-one (21) years, and whether constituting principal or income therefrom, the following powers, in addition to those granted elsewhere in this Agreement and those conferred by law:

(a) To retain any such property as an investment, whether or not trustees are authorized by

law or by any rule of court to invest trust funds in such property.

(b) To sell any such property (other than the limited partnership interest in Associates IV Limited Partnership) at either public or private sale for cash or on credit of any duration, to exchange any such property and to grant options for the purchase of any such property, including, without limitation, stocks, with or without consideration and without any limitation on the period of any such option.

(c) Subject to the restrictions provided in the No-Action Letter, to invest and reinvest in property of any character, real or personal, foreign or domestic, including, without limitation, bonds, notes, debentures, mortgages, certificates of deposit, common and preferred stocks, shares or interests in partnerships or investment trusts and companies and participations in any common trust fund maintained by the Trustee, whether or not trustees are authorized by law or by any rule of court to invest trust funds in such property.

(d) To consent to and participate in, or to oppose, any foreclosure, liquidation or plan of reorganization, consolidation, merger, combination or other similar plan and to consent to any contract, lease, mortgage, purchase, sale or other action by any corporation pursuant to such plan.

(e) To deposit any such property with any protective, reorganization or similar committee, to delegate discretionary power thereto and to pay part of its expenses and compensation and any assessment levied with respect to such property.

(f) To exercise all conversion, subscription, voting and other rights of whatsoever nature pertaining to any such property and to grant proxies, discretionary or otherwise, with respect thereto.

(g) To manage any real property in the same manner as if the absolute owner thereof, including, without limitation, the power from time to time to lease, or grant options to lease, any such real property for any period of time and although any such period may extend beyond the duration of any trust under this Agreement, with any provisions for renewals thereof, without application to any court; to enter into any covenants or agreements relating to the property so leased or to any improvements then or thereafter erected thereon; to insure against loss by fire or other casualty; and to make partition or enter into any agreements of partition of any real property which, or an interest in which, shall at any time constitute part of any trust under this Agreement, even though a Trustee acting hereunder may hold an interest in the same property in the Trustee's own right or in some other capacity, and to give or receive money or other property for equality of partition. To make ordinary and extraordinary repairs and alterations to any building, to raze old buildings, to erect new buildings and to make other improvements; to set up appropriate reserves out of income for repairs and modernization of any building, including reserves for depreciation and obsolescence, to add such reserves to principal and, in creating such reserves, to use the income from any assets of the trust which holds the property with respect to which such reserve is being created; and, for the amortization of any mortgage on any such

property, to use principal and/or income from any assets of the trust in which such mortgaged property is held; in all such cases without thereafter making any adjustment between principal and income.

(h) To transfer any portion of receipts from income to principal on account of depreciation, depletion, or amortization and to allocate in the Trustee's discretion, in whole or in part, to principal and income, all receipts and disbursements for which no express provision is made hereunder, which allocation shall fully protect the Trustee with respect to any action taken or payment made in reliance thereon.

(i) To make loans and borrow money for any purpose including, without limitation, to or from the Trustee individually or others (other than the Settlor or the Settlor's Spouse), upon such terms, with or without security, as the Trustee may deem advisable and to pledge or mortgage any such property as security.

(j) To appoint and compensate agents (including, without limitation, accountants, custodians, investment advisors, money managers and attorneys, and regardless of whether the Trustee is a principal or employee thereof) to act in the Trustee's behalf and to delegate discretionary power to such agents.

(k) To extend the time of payment of any obligation at any time owing by or to the Trustee or any trust under this Agreement and to compromise, settle or submit to arbitration upon such terms as the Trustee may deem advisable, or to

release, with or without consideration, any claim in favor of or against, any trust under this Agreement.

(l) To allocate to two or more trusts under this Agreement an undivided interest in one or more properties or blocks of securities, including, without limitation, stocks, and to administer any two or more trusts under this Agreement as a single trust by holding the principal of such trusts in one or more consolidated funds in which the separate trusts shall have undivided interests; provided, however, that separate records of each trust shall be maintained.

(m) To cause any such property to be held in nominee registration, with or without indication of the fiduciary character thereof, or unregistered.

(n) In dividing or distributing any trust hereunder, or any part thereof, to make partition, division or distribution of property in kind whether equal or disproportionate, and with or without thereafter making any adjustment for any disproportionate income tax bases in such property, as the Trustee may deem advisable, and, for any such purpose, to determine the value of any such property so far as permitted by law.

(o) To exercise any stock options held in any trust hereunder.

(p) To divide property held in any trust hereunder into two or more separate trusts hereunder and to add the principal of any trust hereunder having substantially identical terms to another trust held hereunder to such other trust, the

property so added thereafter to follow the disposition of the fund to which it is added in all respects as to both income and principal, as the Trustee may deem advisable.

(q) To pay or contest any and all taxes assessed against any trust created hereunder.

(r) To do all such acts, take all such proceedings and exercise all such rights and privileges, although not herein, specifically mentioned, with respect to any such property, as if the absolute owner thereof and in connection therewith to make, execute and deliver any instruments and to enter into any covenants or agreements binding any trust hereunder.

5.3. Associates IV Limited Partnership Votes; Change of Trust Situs. In addition to the powers conferred on the Trustee above, the Trustee shall have the power to participate in all, votes in which limited partners of Associates IV Limited Partnership are permitted to participate pursuant to Associates IV Limited Partnership's amended and restated limited partnership agreement, as amended from time to time, and to change the situs of the trust property of any trust under this Agreement.

5.4. Restrictions on Investment Powers. It being the Settlor's desire that (a) the Trustee shall not confine the investments of the any trust hereunder to those authorized by law or by any rule of court (unless the Trustee shall deem such course advisable) and (b) that the Trustee abide by the investment restrictions provided in the No-Action Letter, the Settlor hereby

declares that the Trustee shall not be liable for any loss sustained by any trust hereunder by reason of the purchase, retention, sale or exchange of any investment made by the Trustee in good faith.

5.5. Conflict of Interest. The Trust Fund may include obligations, shares or other interests in certain corporations or businesses of which the Trustee may be a director, partner, shareholder, officer or employee. The Settlor hereby specifically authorizes and empowers the Trustee to exercise with respect to any such obligations, shares or interests (or any obligations, shares or interests in any successor corporations or businesses) any and all of the powers, authorities and discretions provided in this Agreement, including, without limitation, the power to purchase from, sell to or otherwise deal with himself or herself with respect to the same and to retain and vote the same as long as the Trustee may deem advisable. The Settlor directs that no principle or rule of law relating to self-dealing or divided loyalty shall be applied to any acts of the Trustee with respect to any such obligations, shares or interests. The foregoing provisions of this paragraph are intended to amplify and not to limit the powers and authority granted to the Trustee with respect to the Trust Fund.

5.6. Application of Section 11-2.1(k) of the New York Estates, Powers and Trust Law. The provisions of section 11-2.1(k) of the New York Estates, Powers and Trusts Law with respect to underproductive property, as in effect at the time of this Agreement, or such other

statutory provisions as shall correspond thereto, shall not be applicable to any trust under this Agreement.

5.7. Third Parties Dealing with Trustee. Persons dealing with the Trustee shall not be obligated to look to the application of any moneys or other property paid or delivered to the Trustee or to inquire into the Trustee's authority as to any transaction. All powers granted to the Trustee shall continue until actual distribution of the property.

5.8. Trustee's Liability. (a) Any decision of the Trustee with respect to the exercise or non-exercise by the Trustee of any discretionary power under this Agreement, or the time or manner of the exercise thereof, made in good faith, shall fully protect the Trustee and shall be binding and conclusive upon all persons interested in the Trust Fund.

(b) In no event and under no circumstances shall the Trustee incur any liability either individually or as Trustee with respect to any duty, responsibility, power, authority or discretion of the Trustee under this Agreement unless the same shall be done or omitted by the Trustee in actual bad faith, and the Settlor hereby agrees that any Trustee will at all times be protected and indemnified from the Trust Fund from any and all liability, loss, damages or expenses of whatsoever kind or nature which such Trustee, individually or as Trustee, may at anytime sustain or incur or become liable for in connection with this Agreement and any trust hereby created except by reason of gross negligence,

willful misconduct, fraud or had faith on the part of such Trustee.

5.9. Delegation. Any person acting as Trustee hereunder is authorized at any time and from time to time by a writing instrument delivered to a co-Trustee to delegate to such co-Trustee any ministerial duty, responsibility, power or authority. The revocation of any such delegation shall also be in writing and delivered to such co-Trustee.

ARTICLE SIXTH

Income and Principal

Income accrued on any property (whether originally placed in, or subsequently added to, any trust under this Agreement) at the time of its transfer to the Trustee and, with respect to shares of stock (whether originally placed in, or subsequently added to, such trust), dividends declared prior to the transfer of such shares to the Trustee but payable to stockholders of record determined as of a date which is on or subsequent to the date of such transfer, shall be income of such trust. Upon the termination of any estate hereunder, income accrued on property then held in any trust but not yet due and payable, after deducting any charges or advances against it, and dividends on shares of stock declared prior to such termination but payable to stockholders of record determined as of a date which is on or subsequent to the date of such termination, shall belong to the next estate. Distributions in stock of the corporation or association making the

distribution shall be principal. The Trustee is expressly authorized in the Trustee's discretion to amortize premiums paid for trust securities, but the Trustee shall not be required to make any such amortization and shall incur no liability if the Trustee determines that no sinking fund shall be established for amortization of premiums. In the case of securities that are payable at maturity without interest, from time to time there may be transferred from principal to income a pro rata part of the discount or difference between the purchase price and the amount payable at maturity.

ARTICLE SEVENTH

Accounting Obligations

7.1. Accountings: Any Trustee at any time acting hereunder may at any time and from time to time render, to such person or persons eligible to receive income from any trust hereunder as shall be of full age and competent at the time when such account is rendered (hereinafter sometimes referred to as the "Competent Beneficiaries"), an account of the acts and transactions of such Trustee with respect to the income and principal of such trust, from the date of the erection of such trust are from the date of the last previous account of such Trustee, as the case may be; and the Competent Beneficiaries shall have full power and authority on behalf of all persons interested in such trust finally to settle and adjust such account; and upon such account being settled and adjusted to the satisfaction of the Competent Beneficiaries, it shall be binding and

conclusive upon and every person (whether or not then living or then ascertainable) who shall then or thereafter be or become interested in either the income or the principal of such trust, with like effect as a judgment of a court having jurisdiction judicially settling such account in an action in which such Trustee and all persons having or claiming any interest in such trust were parties; and the approval by the Competent Beneficiaries of such account shall constitute a full discharge and release of such Trustee and of the estate of any deceased Trustee for whom such account is rendered, from all further liability, responsibility and accountability for or with respect to the acts and transactions of such Trustee as set forth in said account, as to both income and principal of such trust.

7.2. Judicial Accountings. Nothing contained in this Article shall preclude any Trustee from having an account judicially settled or from filing periodic accounts if such Trustee shall deem such settlement or such filing advisable.

7.3. Disability. If, in any accounting proceeding or in any non-judicial settlement of the Trustee's account, any Party to such proceeding or settlement shall be a person under a disability, service of process upon such person in such proceeding or signature upon such settlement by such person shall not be required if there is another person, not under a disability, who is a party to the proceeding or settlement and who has the same interest as the person under a disability.

ARTICLE EIGHTH

Appointment of Successor Trustees and Co-Trustees

8.1. Successor Trustees. The Settlor shall have the power during his lifetime to appoint successor Trustees to fill vacancies hereunder. If at any time and for any reason WILLIAM B. MATTESON shall cease to act as a Trustee hereunder, and the settlor shall have failed to appoint a successor Trustee within ninety (90) days of the event creating the vacancy, then THEODORE A. KURZ shall become the successor Trustee. Subject to the foregoing, the last person acting as Trustee hereunder shall have the power to designate one or more successor Trustees hereunder.

8.2. Co-Trustee. Any individual Trustee who shall be acting alone shall have the power to appoint a co-Trustee to act with him or her.

8.3. Designation of Trustees; Permissible Trustees. Any designation of Trustees pursuant to this Article shall be made by a duly acknowledged instrument in writing designating one or more persons or series of persons, either natural or corporate, other than the Settlor; provided, however, that there shall at all times be at least one Trustee who is not a current beneficiary of any trust under this Agreement and who is not a related or subordinate party as defined in Section 672(c) of the Internal Revenue Code (or such other statutory provisions as shall from time to time correspond thereto), including without limitation one of the following: the Settlor's Spouse; the Settlor's father, mother, a descendant of the Settlor, a sibling of the Settlor, an

employee of the Settlor, a corporation or any employee of a corporation in which the stock holdings of the Settlor or the trust are significant from the viewpoint of voting control, or a subordinate employee of a corporation in which the Settlor is an executive. Any such instrument of designation shall become effective according to its terms and shall be revocable by a similar instrument at any time before such designation shall become effective. In the event that the same person shall have executed more than one instrument designating Trustees, then the instrument that shall bear the most recent date and shall be unrevoked shall govern.

8.4. Resignation. Any Trustee may resign at any time and for any reason by a duly acknowledged Instrument in writing delivered to each other then acting Trustee, if any, and to such Trustee's successor, and filed with the records of the trust to which it relates.

8.5. No Bond. No Trustee at any time acting under this Agreement shall be required to give any bond or other security for the faithful performance of such Trustee's duties.

8.6. Compensation. No Trustee shall be entitled to compensation for acting as a Trustee unless the Settlor shall otherwise agree in writing. Following the death of the Settlor, each Trustee whose compensation shall not otherwise have been fixed by agreement with the Settlor shall be entitled to receive compensation as provided by the instrument appointing such Trustee, or if no compensation shall have been provided for by

the foregoing provisions of this section, each Trustee's compensation shall be the compensation to which a sole individual Trustee of an express trust shall be entitled under New York law in effect at the time such compensation is payable.

8.7. Self-Dealing Restrictions. No Trustee shall be entitled to (a) exercise any discretion to pay or apply income or principal to himself or herself, (b) exercise any discretion, unless limited by an ascertainable standard, to pay or apply income or principal to any other beneficiary of any trust under this Agreement in which such Trustee shall have a current beneficial interest, (c) make discretionary allocations of receipts or expenses as between principal and income of any trust under this Agreement in which such Trustee shall have a current beneficial interest, (d) exercise any discretion to pay or apply income or principal of any trust under this Agreement in discharge of any of his or her legal obligations; including obligations of support, or (e) make discretionary allocations of receipts or expenses as between principal and income in favor of any beneficiary of any trust under this Agreement to whom such Trustee has a legal obligation of support; provided, however, that the foregoing shall not prevent any other Trustee from making such payment, application or allocation.

ARTICLE NINTH

Income not Taxable to Settlor

Notwithstanding anything herein contained to the contrary, all of the powers granted to the Trustee hereunder shall be exercised solely in and in no event and under powers be exercised from any trust fund under this Agreement taxable to the Settlor pursuant to the applicable provisions of the Internal Revenue Code. If any of the provisions herein shall be found to violate Section 671, *et seq.*, of the Internal Revenue Code (or such other statutory provisions as shall from time to time correspond thereto), so as to cause the income of any trust under this Agreement to be taxable to the settlor, then said provisions shall not be operative, but shall be the eliminated and of no effect. In that event, however, all other provisions of this Agreement shall remain in full force and effect, and shall not be affected thereby.

ARTICLE TENTH

Amendments; Governing

This Agreement shall be irrevocable and unamendable by the Settlor. Subject to the Trustee's power to change the situs of the trust property of any trust hereunder, this Agreement and each trust hereunder shall be governed and construed in all respects according to the laws of the State of New York.

ARTICLE ELEVENTH

Additions to Trust Fund

The Settlor or any other person or an attorney-in-fact acting on behalf of the Settlor (or any other person) may at any time and from time to time increase the Trust Fund by delivering property to the Trustee, or by having the proceeds of insurance policies or other benefits made payable to the Trustee, or by bequest or devise by will. The duties and liabilities of the Trustee shall under no circumstances be substantially increased except with the Trustee's written consent.

ARTICLE TWELFTH

Spendthrift Protections

Neither the principal nor the income of any trust under this Agreement, so long as the same is held by the Trustee, shall be subject to assignment or any other anticipation by the beneficiary for whom the same is intended, nor to attachment, execution, garnishment, sequestration or other seizure under any legal, equitable or other process. If any portion of the principal or income of such trust should, because of any debt incurred by, or other claim against, any beneficiary of any such trust, or by reason of any sale, assignment, transfer, encumbrance, anticipation or other disposition made or attempted by such beneficiary, or by reason of any seizure, attachment, execution, writ or other process, become payable or likely to become payable to any person other than the beneficiary for whom the same is intended, than notwithstanding

anything to the contrary contained in this Agreement, the Trustee in the Trustee's discretion may pay or apply to or to the use of the Spouse of such beneficiary, such beneficiary's then living descendants, or any other relative of such beneficiary, in such shares and proportions, as the Trustee may, from time to time, deem advisable, the share of the principal or income of such trust which, but for the provisions of this Article, would be payable to such beneficiary. Such payment shall be a full discharge to the Trustee with respect thereto.

ARTICLE THIRTEENTH

Savings Clause

Notwithstanding anything to the contrary contained in this Agreement, if any trust hereunder shall not otherwise have terminated pursuant to the provisions of this Agreement, upon the expiration of twenty-one (21) years after the death of the last survivor of the Settlor, the Settlor's Spouse (if the Settlor's Spouse was living on the date of execution of this Agreement) and all of the Settlor's descendants who were living on the date of execution of this Agreement, the Trustee shall transfer, pay over and distribute the then principal of such trust to the Settlor's then living descendants, per stirpes.

ARTICLE FOURTEENTH

Definitions

14.1. Associates IV Limited Partnership. "Associates IV Limited Partnership" shall have the meaning provided in Section 1.3 of Article FIRST.

14.2. Descendants. Each reference herein to an individual's "child", "Children" and words of similar meaning shall include (i) non-marital children who are the legitimate children of such individual, as such term is defined in Section 4-1.2 of the New York Estates Powers and Trusts Laws or to such other statutory provisions as shall correspond thereto at the time any determination of such relationship shall be made (hereinafter "non-marital children") and (ii) adopted persons who were under the age of eighteen (18) at the time they were adopted by such individual and each reference to an individual's "issue", "descendant", "descendants" and words of similar meaning shall include (i) non-marital children and their descendants and (ii) adopted persons who were under the age of eighteen (18) at the time they were adopted and their descendants.

14.3. Internal Revenue Code. Each reference herein to the "Internal Revenue Code" or the "Code" shall be deemed to mean and refer either to the United States Internal Revenue Code of 1986, as amended, or to such other statutory provisions as shall correspond thereto.

14.4. Settlor. "Settlor" shall have the meaning provided in the first Paragraph of this Agreement.

14.5. Skip Person. As used herein, the term "skip person" shall mean and refer to such term as defined in Section 2613 of the Internal Revenue Code.

14.6. Spouse. Each reference herein to an individual's "Spouse" shall mean and refer to the person who is married to and living with such individual at the time or times that any determination of such relationship shall be made, or who shall have been married to and living with such individual at the time of such individual's death; provided, however, that a person who is married to an individual shall be deemed to be living with such individual during any period of temporary physical separation that is unrelated to marital disharmony.

14.7 Trustee. Except as otherwise specifically provided in this Agreement, the term "Trustee" wherever used herein, shall mean and refer to the Trustee or Trustees at the time acting under this Agreement, and except as otherwise specifically provided in this Agreement, the powers, privileges and immunities and the discretions granted herein shall attach to the office of Trustee and shall continue as long as any assets are held in trust under this Agreement and until the final distribution thereof.

14.8. Trust Fund. "Trust Fund" shall have the meaning provided in the second paragraph of this Agreement. Each of the Trust Fund and any share or

subshare held under this Agreement shall be a "trust" under this Agreement.

14.9. Will. Each reference herein to an individual's "Last Will and Testament" or "Will" shall be construed as referring to the will of such individual and any codicil or codicils thereto.

ARTICLE FIFTEENTH

Miscellaneous

15.1. Gender. Whenever necessary or appropriate, the use herein of any gender shall be deemed to include the other genders and the use herein of either the singular or the plural shall be deemed to include the other.

15.2. Headings. The Article and section headings contained in this Agreement are for convenience only and are not a part of this Agreement.

15.3. Date. This Agreement shall become effective as of the day and year first above written.

IN WITNESS WHEREOF, the Settlor and the Trustee have hereunto set their respective hands and seals as of the day and year first above written.

/s/ Joseph Lee Rice, III [L.S.]
Joseph Lee Rice, III, Settlor

/s/ William B. Matteson [L.S.]
William B. Matteson, Trustee

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

On this 30th day of December, 1992 before me personally came JOSEPH LEE RICE, III, to me known and known to me to be the individual described in and who executed the foregoing instrument, and he acknowledged to me that he executed the same.

/s/ Margaret Coro
Notary Public

[NOTARY STAMP]

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

On this 30th day of December, 1992, before me personally came WILLIAM B. MATTESON, to me known and known to me to be the individual described in and who executed the foregoing instrument, and he acknowledged to me that he executed the same.

/s/ Jane C. Nober
Notary Public

[NOTARY STAMP]

SCHEDULE A

One hundred Thousand Dollars ($100,000)

STATE OF NORTH CAROLINA	**IN THE GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION 12 CVS 8740**
The Kimberley Rice Kaestner 1992 Trust, **Plaintiff,** **v.** **North Carolina Department of Revenue,** **Defendant.**	**DEFENDANT'S MOTION FOR SUMMARY JUDGMENT**

* * *

EXHIBIT 1

Joseph Lee Rice, III Family 1992 Trust
EIN #[redacted]3609
Form IT-205 Amended
FYE 12/31/05

Explanation of Changes

The Joseph Lee Rice, III Family 1992 Trust (the "Trust") was established on December 30, 1992 by Joseph Lee Rice, III, then a resident of the State of New York. Since 1995, the Trust has been administered solely by a trustee domiciled outside of the State of New York. The entire corpus of the Trust consists of intangible assets. During the tax year 2005, the Trust received a negligible amount of New York source income from certain of its investment assets. The return for the tax year 2005 is being amended to reflect that

the Trust was not required to file a New York resident fiduciary return for that year. Instead, this return now reports only the amount of New York source income, $2,165, received by the Trust in the period from January 1, 2005 through December 31, 2005.

Based on the doctrine established by *Mercantile-Safe Deposit and Trust Company* v. *Murphy*, 15 N.Y.2d 579, 203 N.E.2d 490, 255 N.Y.S.2d 96 (1964) and its progeny (as acknowledged by the New York Department of Taxation and Finance with the adoption of 20 NYCRR §105.23(c) (2003), and thereafter by the New York Legislature with New York Tax Law §605(b)(3)(D)), the Trust is not required to pay income tax on the non-New York source income collected from January 1, 2005 through December 31, 2005.

In the past, courts in New York and elsewhere have carefully examined whether a state's taxation of a trust satisfies the requirements of the Due Process Clause of the U.S. Constitution. Beginning with *Mercantile-Safe Deposit & Trust Co.* v. *Murphy*, 15 N.Y.2d 579, 203 N.E.2d 490, 255 N.Y.S.2d 96 (1964), New York courts have struck down resident taxation of trust based solely on the domicile of the donor or beneficiaries of the trust. We are aware of no court decision supporting the taxation of the Trust as resident (and therefore subjecting to New York income tax all of the worldwide income of the Trust) based on the Trust's indirect receipt of a negligible portion of its income from New York sources even though the Trust has no trustees or assets located in New York State.

Taxation of the Trust as a resident would violate the two requirements under the Due Process Clause for resident taxation of all the Trust's worldwide income. First, the Trust did not have sufficient contacts with New York from January 1, 2005 through December 31, 2005 to permit such taxation. The Trust's only contacts with the State in 2005 were the domicile of its donor at the time the Trust was created many years earlier and a negligible amount of income from intangible assets – both contacts that New York courts have held to be constitutionally insufficient to support taxation as a resident trust. The State did not provide any benefits to the Trust, much less benefits sufficient to support the resident taxation of all of the Trust's worldwide income.

Second, unless applied to the Trust's income in the manner reported in this amended return, the State's tax regime (and in particular, Tax Law §605(b)(3)(D)) would not provide for any apportionment to take into account the extent of the Trust's activities in the State. Under the Due Process Clause, a taxing jurisdiction may constitutionally tax an entity's income only in proportion to that entity's activities in that jurisdiction. The taxation of 100% of the Trust's worldwide income in 2005 – when only .092% (.00092) of such income was indirectly received from New York sources – would not in any way even attempt to correspond to the true value of the Trust's income derived indirectly from activities in New York. In fact, the tax paid on the original return was 131 times the amount of New York source income.

We urge the Department to avoid these constitutional difficulties by refunding the total payments made on account to date, consistent with the application of Tax Law §605(b)(3)(D) in a manner respectful of the requirements of the Due Process Clause.

NORTH CAROLINA	IN THE GENERAL COURT OF JUSTICE
WAKE COUNTY	SUPERIOR COURT DIVISION

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST,

Plaintiff,

v.

N. C. DEPARTMENT OF REVENUE,

Defendant.

No. 12-CvS-8740

DEPOSITION OF KIMBERLY RICE KAESTNER

TUESDAY, JUNE 24, 2014

Conference Room 3
Moore & Van Allen, PLLC
430 Davis Drive, Suite 500
Morrisville, North Carolina
1:00 p.m.

Volume 1 of 1

Pages 1 through 24

* * *

[6] Carolina, I went to UNC Chapel Hill and received a master's in education in school counseling.

Q What was your bachelor's in?

A History.

Q And did you work in the area of counseling at any time?

A No.

Q What's your date of birth? I apologize. I don't usually ask that, but it becomes relevant.

A No worries; June 2nd, 1969.

Q And what are the ages of your children?

A 8, 10, and 12.

Q Are you aware of what this lawsuit is about?

A Yes.

Q Can you explain what it concerns?

A Sure. Basically, if it –

Mr. Silver: Ms. Kaestner, I will caution you that any information you've received from me about the –

The Witness: (interposing) Uh-huh.

Mr. Silver: – lawsuit I consider as privileged.

The Witness: Uh-huh.

Mr. Silver: If you have a general understanding that predates or is apart from the information you acquired from me, please tell Ms. Vincent what you understand or know.

The Witness: Okay.

[7] Mr. Silver: I just want to be sure that – our conversations, as you know, are privileged, and I don't believe Ms. Vincent is intending to inquire into those.

The Witness: Okay.

A A trust that was set up for me is being – is owed taxes – supposedly owed taxes and paid those taxes, but David Bernstein as the trustee is questioning whether that was – whether that was valid and is therefore asking the state to pay back those taxes.

Q What do you know about the history of the trust?

A Not very much, not very much.

Q Do you know who created the trust?

A Yes. My father created the trust.

Q And do you know the purpose of creating that trust, what it was for?

A Yes, to – to give me money.

Q And also some of your siblings?

A Yes.

Q And what do you know about what has happened to that trust through the years?

A That – well, that trust was one large trust and for myself it is – it became two trusts. And when I turned 40, it was-to become in my ownership. That's about it.

Q Okay. You know David –

A (interposing) Uh-huh.

[8] Q – Bernstein –

A (interposing) Uh-huh.

Q – who is here? Did you know any of the earlier trustees?

A I – yes, knew of them, not – I knew that Mr. Madison, I believe it was Madison, was the original trustee, or one of the original trustees.

Q Did you personally have any interactions with Mr. Madison?

A No

Q Have you personally had interactions with Mr. Bernstein?

A Yes.

Q Were you asked about whether you wanted to receive the assets of the trust when you turned 40?

A Yes.

Q And who asked you that?

A I don't recall, or let me – let me restate that. I believe my father; my father.

Q And what was your response?

A We had several discussions, and I felt nervous about being given that sum. of money and unsure as to whether I would do a good job with that money.

Q So at the time of the discussions you were aware of the size of the trust, or at least your portion?

[9] A Yes.

Q Do you recall what the size was back then?

A Yes.

Q And what was it?

A When my father made me aware of the trust, he told me it was worth about $13 million.

And at what point was this that he made you aware of the trust?

A When I was 37.

Q So you weren't aware of it at the time it was formed?

A No.

Q And what was the culmination of your discussions on whether or not you would receive the assets?

A Can you ask me that a different way?

Q Sure; absolutely. The discussions that you had with your father on whether or not you would take the assets from the trust –

A (interposing) Uh-huh.

Q – what was the final decision, the final determination, about what you wanted to do?

A At that time it was to extend the trust.

Q And did you have discussions with anyone other than your father about that decision?

A Yes.

Q Who?

[10] A David.

Q Okay. And I'm certainly not intending to infringe on any attorney privilege, but what was his advice as the trustee?

Mr. Myrick: Well –

Mr. Silver: (interposing) Objection to form, and Ms. Kaestner, again, there were certain conversations you had with Mr. Bernstein and other members of his firm as counsel or attorneys for you.

As I understand Ms. Vincent's questions, she's asking to what extent did you have conversations with Mr. Bernstein regarding the trust that were not within the scope of that attorney-client relationship.

Mr. Myrick: And to put that a little bit differently, to the extent that David was giving you legal advice or advising your that would be privileged, and that would be something that I would ask that you not testify to.

The Witness: And I was just going to say I don't recall.

Ms. Vincent: Okay.

The Witness: That was pretty much my – my answer.

Mr. Bernstein: I'm happy to know how meaningful my words were back at the time.

By Ms. Vincent:

Q What information do you currently receive about the

* * *

[17] A – I didn't get any advice while it was still under David because he was running it. So it wasn't until we went to David and said we'd like to dissolve the trust that we gave it to our investment company, which is Keel Point.

And now we have the ability to, you know, give advice and have input. But when it was the structure of the trust that you were talking about, we didn't have any – you know, David made the investments David and Rocaton handled everything.

Q So were you able to provide David or Rocaton, the same time period, with input on the investments?

A I do not recall.

Q Did you ever have any concerns about whether the investments were socially responsible, again during that same time period of '06 to '012?

Mr. Myrick: Object to form.

Mr. Silver: Object – right, same objection.

Q You can still answer.

A Can you tell me what you mean by social? I'm sorry.

Q By socially responsible investments?

A Yes.

Q In other words, like were you – did you have any input on if you felt like some investment was maybe socially unacceptable to you, like it was in blood diamonds or something?

[18] A Uh-huh.

Q Did you have any input in that type of decision. making?

A I did not understand the investments enough to give any input.

Q Could you borrow money from the trust during that time period?

A We did borrow. I mean we got a loan.

Q Were there any limitations that you are aware of on being able to get a loan or not being able to get a loan from the trust?

A Can you rephrase that?

Q Yeah. I'm asking if there were any limitations on you being able to get a loan, from the trust.

A Well, it was very clear that David could say no. We requested a loan, and he said yes.

Q And do you remember the amount of that loan?

A $250,000.

Q Do you know if it's been paid back?

A Yes.

Q Yes, you know, or yes, it has been paid back, just to be clear.

A Yes, it was paid by the other trust that was set up at that time.

Q Was the loan used – what was it used for?

* * *

Case: 12CVS8740 Deponent: Kimberley Rice Kaestner
Date: 6/24/14

Page	Line	Correction	Reason
8	6	change to "Matteson"	misspelled
9	21	Insert "Davids decision	Between was and to
11	25	change to "Plaintiff trust"	change
Whole	Document	change to "Kimberley"	Name misspelled

_____

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
STATE OF NORTH CAROLINA
WAKE COUNTY

---------- X

THE KIMBERLEY
RICE KAESTNER 1992
FAMILY TRUST,

Plaintiff,

– against – 12 CVS 8740

NORTH CAROLINA
DEPARTMENT OF REVENUE,

Defendant.

---------- X

VIDEOTAPED DEPOSITION OF DAVID H. BERNSTEIN, taken by Defendant, pursuant to Notice, at the offices of Debevoise & Plimpton LLP, 919 Third Avenue, New York, New York, on Friday, May 2, 2014, commencing at 9:02 a.m., before Chandra D. Brown, a Registered Professional Reporter and Notary Public within and for the State of New York.

* * *

[4] I want to ask you starting about the history of the plaintiff from the time the Joseph Lee Rice, III Family Trust was formed in 1992.

Can I have you just give me a brief overview?

A The Trust was formed by Joe Rice in 1992. Bill Matteson was the trustee at that time and did continue

for a number of years until I believe I became trustee in late 2005 or so.

I know that we've given you the documents. It's a lot of dates, so, obviously, happy to look at documents and walk you through those.

Q Can you tell me more about what has – has happened to the Trust over time in terms of – I know there's been splits, amendments, whatever. Can you give me that kind of overview of the plaintiff?

A Well that's – we're talking about over 20 years of history of the Trust. But in 2002, under the terms of the Trust, the Trust was split into three sub-trusts. One share for each of the – of the – of Mr. Rice's three [5] children.

In 2005, when I became trustee, one of the things I then did was I actually separated the trust into separate trusts. So Kimberley's trust was separated out.

But I'm sorry I'm not going to be able to give you very specific dates. It would help me much more, obviously, in walking you through those amendments, all of which we've provided to you, if you show them to me, and I can walk you through what each of them were.

Q Okay.

When you separated, what you referred to as separated the Trust in 2005, can you explain to me the difference between having split them in 2002 and what happened in 2005?

A Well, I'm not a – I'm not a trust and estate lawyer. My understanding – and believe it was 2006 when I actually split the trusts. Again, I know you have those documents.

My understanding is under the terms of the Trust in 2002, it was the 10-year anniversary of the Trust, and per its terms, the Trust was [6] split into separate shares. When I then physically did that for the administrative convenience of having three different trusts that was in 2006. But the – as I understand it, the legal impact was the same. It really was just confirming what had been done by operation of the Trust itself in 2002.

Q Was there previously – was the accounting being done differently or anything different in the administration of the Trust between the time that it was just being split versus separately administered?

A There had not been an accounting previously. So one of the things that I did when I became trustee was ask that an accounting be done, and it was in the process of the accounting that we split the trusts. Or at least in the process of preparing accounting, we decided to do the split of trusts. That would help with the administrative convenience of the operation of three different trusts.

And I believe we've turned the accounting over to you and it's a pretty lengthy document.

* * *

[8] split the trusts after 2006, I did make some different investment decisions for the three trusts because the beneficiaries are in three very different places in their lives, and I didn't believe that the investment philosophy for all three trusts needed to be the same. One of Mr. Rice's children for example, is much younger and so has a very different investment time frame.

Q What – your relationship, you've been the trustee for the Trust since '05? I believe the date is 12/21/05.

A Yes. That sounds right to me.

Q Are you the attorney for the Trust?

A My law firm is the attorney for the Trust and I do – and I do provide legal advice to them as well. So, yes, I have – I have served as attorney for – in some respects.

Q Are you an officer for some of the parts of the Trust?

A I'm the trustee for the Trust. The Trust doesn't have any officers.

Q The Trust is a shareholder in some corporations. Are you an officer of those

* * *

[10] I probably was misremembering. It may have been – it may be a different entity. And I think the accounting will probably have all of these laid out.

Q Was there – was there a blocker corporation formed?

A I don't believe that was the legal name for it, but I think that – I think that the purpose of one of these entities dealt with a mechanism for protecting the – certain assets from taxation in the State of New York.

Q Are the holdings of the Trust all intangibles?

A I'm not sure. that do you mean by intangibles, I'm sorry?

Q All stocks, bonds, investment instruments.

A Yes. Those are among the holdings of the Trust.

Q Does the Trust hold real property?

A No, not to my knowledge. No, it does not hold real property.

Q Are you aware of any other assets that are – what would be called legally tangible assets?

* * *

[16] the power to make amendments along – including the one I did do where I divided the Trust. And let me just continue on.

Then on the top of Page 16, subparagraph (p) gives me the right to divide property into two or more separate trusts and that – that also, of course, is what I did when I divided the trusts in 2006.

Subparagraph (l) also references my power to allocate property to other trusts.

Subparagraph (r) gives me the power to take any other acts and to exercise all rights and privileges, even if not specifically mentioned here, as if I'm the absolute owner thereof, and I think this gives me the power to do further acts that are permitted under New York law. And my understanding was that New York law gives me the ability to make amendments even beyond the powers that are specified in the document.

Q All right. I appreciate that.

While we're on this document there where you read at the end of powers on Page 16, it talks about in 5.3 at the end of that paragraph

* * *

[38] page?

MR. MYRICK: Sure, I have no objection to that.

I don't have it with me in this room. I'll have to get it and we'll have to come back to it.

MS. VINCENT: We'll come back to it then. Thank you, though.

MR. MYRICK: Just happy to do anything I can to get it right.

A While – we can check this, but I will say that my – my best guess, I think I'm not supposed to guessing in a deposition, but my best guess is that it is a

reference to the Kimberley Rice Kessler [sic] 1992 Family Trust. And when we have a chance to look at the accounting, we'll try to put it in context and see if we can confirm that for you.

Q Thank you. Thank you

When Ms. Kaestner turned 40 on June 2nd of 2009, were all the assets delivered to her?

A They were not.

Q And why not?

A I exercised my discretion before she [39] turned 40 to pour the assets into a new trust. That did not include as a provision distribution of assets at age 40.

Q And what was the name of the new trust?

A I will not get this fully correct but it had the date 2009 in it. So it may – it was a Kimberley Rice Kaestner Trust, and it may have been the Kimberley Rice Kaestner 2009 Trust, but I'm going from memory there since I don't have the documents in front of me.

Q Was the '07 Special Asset Trust the only special asset trust that was made in connection with the Kimberley Rice Kaestner Trust, the plaintiff?

A I'm not a hundred percent certain of this, but my recollection is that I created a 2009 Special Asset Trust at the same time that I created the 2009 Family Trust or Kimberley Kaestner Trust. Those aren't the formal names of the trusts, but that's my best

recollection. And it was for the same purpose. It was because I exercised my discretion not to distribute the assets to Ms. Kaestner at the time when she was going to reach the age of 40.

* * *

[41] clear for the record.

BY MS. VINCENT:

Q So in terms of you having exercised your discretion, was that being referenced as the Trust being extended?

A Yes. We've used that reference internally in discussing what we were going – what I was doing with that pour-over.

Q Was this – these pour-overs, was this essentially what is often referenced as decanting the Trust?

A I believe that's correct.

Q Going back to blocker corporations, why was the Trust interested in a blocker corporation?

MR. MYRICK: Just to be clear, when you used the term "blocker corporation," that was your term.

MS. VINCENT: Right.

MR. MYRICK: Not the witness'.

A We – so we created Rice Family Investors, (KER), Inc. to hold certain assets. And the Rice Family Investors (KER), Inc. entity held a number of limited

partnership investments and [42] that was – that entity was owned by the Kimberley Rice Kaestner 2007 Special Asset Trust. That Trust was a grantor trust and it was created for the purpose of having all of the income from those assets – all of the income from those assets was reported on Mr. Rice's tax returns because he was the settlor.

And so the goal here was to increase the value of the Trust by not having the Trust have to pay its on taxes but by having Mr. Rice actually pay the taxes. And as I understand it, the way the grantor trust works, even though he was paying the taxes, that was not deemed a further gift to the Trust. And so it was way of increasing the assets in the Trust by not having the Trust have to pay its taxes but instead Mr. Rice paid the taxes.

Is that clear and is that answering your question?

Q That does answer my question. Thank you.

I want to ask you about the states in which tax returns have been filed. In terms of the plaintiff –

[43] A Yes.

Q – what states have tax returns been filed in?

A New York and North Carolina. And let me just think for a moment. I believe that – I think that some of the limited partnership investments there – may have filed tax returns for all of the limited partners in other states. This would probably be reflected on our tax returns if that's the case. But my – actually, you

know what, let me just take that back. Let me take that back. That's not correct.

The plaintiff – the plaintiff filed tax returns only in New York and North Carolina. I'm thinking of a different trust for Mr. Rice.

Q It looks like this was taken from one of the invoices to the Trust, they paid corporate tax in Connecticut in '07.

A Can you show me the document that you're looking at and I'll be happy to –

Q I'm going to have to actually search. I did not notate what that was. It may have been corporate tax for Rice Family Trust Investors.

* * *

[48] Q And what was the due date on the note?

A It was a open credit facility. There was no particular due date that I recall. There probably was a very far outside date, but, I'm sorry, I don't recall the due date off the top of my head.

Q So the interest rate set at the lowest rate that the IRS would allow?

A Yes, I believe that's correct.

Q And when was that loan made?

A I'm not going to remember with specificity but it was probably – it was probably in 2008 or 2009.

Q The loan to Ms. Kaestner?

A The loan to Ms. Kaestner. Ms. Kaestner and her husband wanted to invest in vanilla and asked me if they could have a loan so that they could make that investment. And they needed it for a short time until they could raise the funds on their own. So I agreed to loan them the money for their vanilla investment.

I never did follow up to ask them how that went, but while I was preparing for the deposition that question did come to my mind.

[49] Q When approximately was that loan?

A I think it may have been 2007 or 2008. That's my best recollection.

Q And what were the terms?

A I charged them a low interest rate. I think the lowest that the IRS would allow. And my recollection is that it was repaid within about six months or so.

Q Was that also open credit?

A What do you mean by that? I'm sorry.

Q You had referenced open credit on the special asset trust.

A No. No. This was a one-time – this was not an open credit facility.

Q Did it have a specific due date?

A I don't recall off the top of my head, but I'm sure that every promissory note – I'm pretty sure that

every promissory note has an outside due date, so I have to believe the answer is yes.

Q Or it could have been just due upon call?

A I don't recall. I would have to go back and look at the promissory note.

Q All right.

* * *

[52] vanilla.

So would – this entry, what does that mean, occurred on May 29th?

A The – I – the trust – the Kimberley Rice Kaestner 1992 Family Trust had a promissory note from Ms. Rice or Ms. Kaestner, I'm not sure why they refer to her as Kimberley Rice in the accounting, perhaps that's what was – on the promissory not [sic].

In any event, the Kimberley Rice Kaestner 1992 Family Trust had a promissory note and it was among the assets that I poured into the 2009 Trust. And that probably helps me recall that at least as of May 29, 2009 that note had not yet been paid. But I seem to recall it was paid relatively promptly. It has been paid off, obviously.

Q And this accounting would just be accounting. The face value wouldn't be including the interest?

A This just shows the face value. This doesn't show the interest. That's correct. If you'll help me with

the reference to par, what is that indicating, 250,000 par?

* * *

[68] reviewing with Rocaton, this is a meeting that I had with the three Rocaton individuals identified. We were reviewing the performance of the Trust in 2007. We were discussing some issues that arose with one of our investments, Partech. And then, as you can see, at the bottom of agenda we discussed Rocatan's fees and we discussed changing the custodian. The custodian of the Trust at the time had been State Street Bank.

Q So the participants in this meeting were limited to persons from your firm and persons from Rocaton?

A Just me. Me and the three Rocaton people.

And I would need to look at my calendar entries to see whether I met with them here in New York or – their offices are in Connecticut near my home and so I would frequently meet with Rocaton in Connecticut.

Q That's fine.

A You don't care. Then I won't look.

Q Okay. Thank you.

Have you had requests by the beneficiaries, or let's say by Mr. or

* * *

[70] I had absolutely no interest in it. And that was in the context of them deciding to invest in it themselves and that lead to the loan that was already discussed.

(Whereupon, the aforementioned document Bates stamped KRK0003667, was marked as Bernstein Exhibit 7 for identification as of this date by the reporter.)

BY MS. VINCENT:

Q I've handed you what's been marked Exhibit Number 7. Its KRK3667.

A Yes.

Q If you will look at that note.

Is this referencing the presentation that you've been speaking. to that happened on July 23 of '07?

A Yes. In fact, the next page of the Bates record is the actual presentation. So if you turned to 3668, you would have seen the presentation of slides.

Q In the second paragraph of this exhibit, it talks about illustrate recommended spending levels from the Trust.

Can you tell me what that's referring to?

[71] A Well, why don't I look at the document again.

Yes, I can.

So we were introducing Mrs. Kaestner for the first time, really, to details about the Trust, including the

size of the Trust, which was a pretty substantial asset. And among other things, Rocaton talked about the importance of sustaining trust assets and how investments of this size, it they are untapped, can grow quite substantially. And then offered some alternative projections, if Ms. Kaestner showed some interest, and if, of course, in my discretion would have been amenable to it in getting income from the Trust.

Rocaton put together a model that would show, based on certain investment return projections, if you wanted to remove funds from the Trust each year, what would that do to the Trust, how would the Trust grow, when would the Trust end, for example. So that is the projections that were referenced in his e-mail.

Q So this would be projections if she decided to – she wanted to request money from

* * *

[73] as an important asset to be preserved and maintained.

Q And did Ms. Kaestner indicate at or after that meeting what her preferences were?

A She indicated that – well, she was – the answer is yes. I mean, of course, she was quite pleased to hear about the asset, She and her husband told me that they intended to use a very substantial chunk [sic] this for charitable endeavors. They are very active it Durham Cares and in their church in. Durham, and I know that they are very excited about what they would be able to do with charitable giving, and this of course,

is an amazing asset that will allow them to do much more than they are doing on their own.

But she did tell me that she had no interest in taking advantage of the spending projections, the spending model. They were not looking for distributions of income from the Trust. Indeed Ms. Kaestner's husband is quite a successful businessman and this is a very nice asset for them to have, but they didn't have any need for income.

* * *

[87] this, please destroy them.

THE WITNESS: What was the question again? Could you read that back for me, please?

(Whereupon the requested question was read back by the Court Reporter.)

A I'm sure I did.

Q Do you recall the nature of your response?

A Generally that I didn't think – well, that I didn't think, well two things: This was during the market crash of 2008. And so I believe I told the Kaestners that, of course, the Trust was taking a hit as were almost all investments, but that we were well-diversified and that we were not, the Trust assets were not down nearly as much as the general market, thanks to our diversification. And I told them that I did not think it was appropriate to do regular reporting.

Q And so the information they have on the status of the assets has not been regular in any way since this request in '08?

A That's correct.

I didn't want to get into having lengthy discussions with the Kaestners about the

* * *

[89] BY MS. VINCENT:

Q How often have the Kaestners come to New York to meet with you?

A That would be in my calendar records again. Quite infrequently.

So we've already discussed the July 23, 2007 meeting. And then I met on October 30, 2008.

Q That meeting was here in New York?

A It was on this floor, Conference Room 35J. Just down the hall.

Q And what was the content of that meeting?

A I believe that was actually the meeting when I was responding to the e-mail you showed me, to provide them or to provide Mr. Kaestner, I think it was only that he was in New York at that time, with a update on how the Trust was doing through the market turmoil of 2008.

Q And you don't recall any other meetings with them in New York City?

A I do not.

Q Have you ever gone to North Carolina to meet with them?

A I have not.

* * *

[93] *** ERRATA SHEET ***

NAME OF CASE: THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST vs. NORTH CAROLINA DEPARTMENT OF REVENUE

DATE OF DEPOSITION: 5/2/14

NAME OF WITNESS: David H. Bernstein

Reason codes:

1. To clarify the record.
2. To conform to the facts.
3. To correct transcription errors.

Page 5 Line 3 Reason 1
From 2005 to 2006

Page 5 Line 5 Reason 1
From trusts to accounts
Page 5 Line 15 Reason 1
From 2005 to 2006

Page 5 Line 17 Reason 1
From 2005 to 2006
Page 5 Line 21 Reason 1
From _____ to after trusts – add: into separate accounts

Page 6 Line 4 Reason 1
From trusts to accounts
Page 6 Line 18 Reason 1
From _____ to after trusts – add: shares into separate accounts
Page 6 Line 19 Reason 1
From _____ to after preparing – add: the
Page 6 Line 20 Reason 1
From do the split of to split the

[ERRATA SHEET CONT'D] *** ERRATA SHEET ***

NAME OF CASE: THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST vs. NORTH CAROLINA DEPARTMENT OF REVENUE

DATE OF DEPOSITION: 5/2/14

NAME OF WITNESS: David H. Bernstein

Reason codes:

1. To clarify the record.
2. To conform to the facts.
3. To correct transcription errors.

Page 6 Line 21 Reason 1
From _____ to after trusts – add: shares into separate accounts

Page 7	Line 23	Reason 1
From		to after Trust – add: shares into separate accounts
Page 8	Line 2	Reason 1
From after		to shares into separate accounts in
Page 12	Line 14	Reason 1
From trusts		to accounts.
Page 16	Line 9	Reason 1
From 2006		to 2007
Page 18	Line 3	Reason 1
From trusts		to accounts
Page 19	Line 21	Reason 1
From in 2006		to from 2007
Page 20	Line 15	Reason 1
From		to add a period (.) after Trust
Page 20	Line 16	Reason 1
From		to delete line 16

[ERRATA SHEET CONT'D] *** ERRATA SHEET ***

NAME OF CASE: THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST vs. NORTH CAROLINA DEPARTMENT OF REVENUE

DATE OF DEPOSITION: 5/2/14

NAME OF WITNESS: David H. Bernstein

Reason codes:

1. To clarify the record.
2. To conform to the facts.
3. To correct transcription errors.

Page 20	Line 17	Reason 1
From		to delete: the – and in – I'm sorry.
Page 20	Line 18	Reason 1
From		delete: I misrecalled it being 2006.
Page 20	Line 23	Reason 1
From		to delete: No.
Page 23	Line 21	Reason 1
From		to delete everything after 2006.
Page 23	Line 22	Reason 1
From document. But in		to In
Page 23	Line 23	Reason 1
From		to delete: I did an amendment where
Page 23	Line 24	Reason 1
From		to after trusts add: share into separate accounts

Page 22 Line 25 Reason 1
From trust to account
Page 24 Line 21 Reason 1
From I didn't – I to In 2006,
documented that in

[ERRATA SHEET CONT'D] *** ERRATA SHEET ***

NAME OF CASE: THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST vs. NORTH CAROLINA DEPARTMENT OF REVENUE

DATE OF DEPOSITION: 5/2/14

NAME OF WITNESS: David H. Bernstein

Reason codes:

1. To clarify the record.
2. To conform to the facts.
3. To correct transcription errors.

Page 24 Line 22 Reason 1
From to delete line 22

Page 24 Line 23 Reason 1
From to delete line 23
Page 24 Line 24 Reason 1
From to delete: that was –
that was when

Page 24 Line 25 Reason 1
From to after split add: into
separate accounts
Page 25 Line 8 Reason 1
From shares to accounts

Page 25 Line 18 Reason 1
From document to separation
Page 25 Line 25 Reason 1
From Dubilier to Dubilier & Rice

Page 26 Line 16 Reason 1
From _____ to delete: If you had that
Page 26 Line 17-19 Reason 1
From _____ to delete lines 17 – 19

[ERRATA SHEET CONT'D] *** ERRATA SHEET ***

NAME OF CASE: THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST vs. NORTH CAROLINA DEPARTMENT OF REVENUE

DATE OF DEPOSITION: 5/2/14

NAME OF WITNESS: David H. Bernstein

Reason codes:

1. To clarify the record.
2. To conform to the facts.
3. To correct transcription errors.

Page 27 Line 5 Reason 1
From _____ to delete &

Page 27 Line 6 Reason 1
From Dubilier to Dubilier & Rice
Page 27 Line 6 Reason 1
From for to is one of its

Page 27 Line 7 Reason 1
From limited partnership to Limited Partnerships

Page 28	Line 4-5	Reason 1
From		to delete lines 4 and 5
Page 28	Line 6	Reason 1
From amendment		to separation
Page 35	Line 3	Reason 1
From LIR		to LAR
Page 38	Line 16	Reason 1
From Kessler		to Kaestner
Page 39	Line 6-11	Reason 1
From delete existing text		to "The KER Family Trust"
Page 39	Line 19-20	Reason 1
From 2009		to KER and delete "or Kimberley Kaestner Trust
Page 49	Line 3-4	Reason 1
From I think it may have been in 2007 or 2008		to January, 2009 and delete Line 4
Page 51	Line 14-16	Reason 1
From		to after Trust on L 14; delete next sentence
Page 52	Line 10	Reason 1
From not		to note

[ERRATA SHEET CONT'D] *** ERRATA SHEET ***

NAME OF CASE: THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST vs. NORTH CAROLINA DEPARTMENT OF REVENUE

DATE OF DEPOSITION: 5/2/14

NAME OF WITNESS: David H. Bernstein

Reason codes:

1. To clarify the record.
2. To conform to the facts.
3. To correct transcription errors.

Page 59 Line 9/ Reason 1
From shares to accounts

Page 60 Line 20 Reason 1
From I'm sure to I suspect
Page 60 Line 22 Reason 1
From would to could

Page 61 Line 14 Reason 1
From an appropriate to inappropriate
Page 62 Line 5 Reason 1
From _____ to add: during the periods at issue

Page 64 Line 7 Reason 1
From ours to our production
Page 66 Line 4 Reason 1
From file to final

Page 67 Line 19 Reason 1
From Green Spring to Greenspring

Page 70 Line 23 Reason 1
From _____ to delete: illustrate

[ERRATA SHEET CONT'D] *** ERRATA SHEET ***

NAME OF CASE: THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST vs. NORTH CAROLINA DEPARTMENT OF REVENUE

DATE OF DEPOSITION: 5/2/14

NAME OF WITNESS: David H. Bernstein

Reason codes:

1. To clarify the record.
2. To conform to the facts.
3. To correct transcription errors.

Page 73 Line 11 Reason 1
From it to in

Page 79 Line 7 Reason 1
From 2009 to June 2, 2009

Page 81 Line 23 Reason 1
From them. to them during the period at issue.

Page 83 Line 20 Reason 1
From _____ to after but add: during the period at issue

Page 84 Line 3 Reason 1
From _____ to add: during the period at issue

Page 87	Line 23	Reason 1
From		to add: during the period at issue
Page 88	Line 8	Reason 1
From		to delete: even
Page 88	Line 9	Reason 1
From after		to during
Page 88	Line 9	Reason 1
From		to add after period: at issue
Page	Line	Reason
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/s/ David H. Bernstein
David H. Bernstein

STATE OF NORTH CAROLINA COUNTY OF WAKE	IN THE GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION 12-CVS-8740
THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST, Plaintiff, v. NORTH CAROLINA DEPARTMENT OF REVENUE, Defendant.	**RESPONSE IN OPPOSITION TO DEFENDANT'S MOTION FOR SUMMARY JUDGMENT and REPLY IN SUPPORT OF PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT** (Filed Oct. 6, 2014)

* * *

NORTH CAROLINA WAKE COUNTY	IN THE GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION
THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST, Plaintiff, v. N. C. DEPARTMENT OF REVENUE, Defendant.	No. 12-CvS-8740

DEPOSITION OF KIMBERLY RICE KAESTNER

TUESDAY, JUNE 24, 2014

Conference Room 3
Moore & Van Allen, PLLC
430 Davis Drive, Suite 500
Morrisville, North Carolina
1:00 p.m.

Volume 1 of 1

Pages 1 through 24

* * *

[9] A Yes.

Q Do you recall what the size was back then?

A Yes.

Q And what was it?

A When my father made me aware of the trust, he told me it was worth about $13 million.

Q And at what point was this that he made you aware of the trust?

A When I was 37.

Q So you weren't aware of it at the time it was formed?

A No.

Q And what was the culmination of your discussions on whether or not you would receive the assets?

A Can you ask me that a different way?

Q Sure; absolutely. The discussions that you had with your father on whether or not you would take the assets from the trust –

A (interposing) Uh-huh.

Q – what was the final decision, the final determination, about what you wanted to do?

A At that time it was to extend the trust.

Q And did you have discussions with anyone other than your father about that decision?

A Yes.

Q Who?

* * *

[12] Q And that would be the successor trust that came into being when the assets were rolled over, poured over?

A Well, my understanding is that there were two trusts along, like the plaintiff trust and another trust.

Q Okay. And then what is your understanding of what happened thereafter?

A Well, when it was extended, when it went beyond – it was extended, and I really don't recall what it became after that.

Q This is extended beyond your having reached the age of 40?

A Yes.

Q And so is the one that was extended beyond the age of 40 – is that the one that you are testifying you believe was dissolved?

A Everything was dissolved. It – yeah, everything was dissolved, no longer is in trust form.

Q So none of those assets you believe are currently in a trust?

A Well, so now we have those assets managed by our own management firm, and some of it – I correct myself. Some of it is still in trust form as originally invested by David. I don't see it as a trust just because the formal – the way it was formally established is no longer in existence, and we have our own management company now taking care of it.

[13] Q And what is that management company?

A It's called Keel Point, and they're in Virginia.

Q For what period of time from the time you became aware of the trust until trust dissolved, you believe it dissolved, what was that time period? How many years, if you know, or months or –

A That I became aware of it to the time it –

Q (interposing) Uh-huh.

A – it was dissolved or –

Q (interposing) Uh-huh.

A – came under –

Q (interposing) Yes.

A – my ownership; so 2007 to 2012.

Q Okay. So during that time period, from 2007 to –

A (interposing) 2006 to 2012.

Q Okay. From 2006 to 2012 –

A (interposing) I was made aware of it in 2006 and dissolved it in 2012.

Q And from that point that you became aware of it –

Mr. Myrick: Can I clarify what "it" is?

Ms. Vincent: The plaintiff trust.

Mr. Myrick: Okay, okay.

By Ms. Vincent:

Q From the time you became aware of the plaintiff trust –

* * *

Case: 12CVS8740 Deponent: Kimberley Rice Kaestner
Date: 6/24/14

Page	Line	Correction	Reason
8	6	change to "Matteson"	misspelled
9	21	Insert "Davids decision	Between was and to
11	25	change to "Plaintiff trust"	change
Whole	Document	change to "Kimberley"	Name misspelled

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
STATE OF NORTH CAROLINA
WAKE COUNTY

---------- X

THE KIMBERLEY
RICE KAESTNER 1992
FAMILY TRUST,

Plaintiff,

– against –

12 CVS 8740

NORTH CAROLINA
DEPARTMENT OF REVENUE,

Defendant.

---------- X

VIDEOTAPED DEPOSITION OF DAVID H. BERNSTEIN, taken by Defendant, pursuant to Notice, at the offices of Debevoise & Plimpton LLP, 919 Third Avenue, New York, New York, on Friday, May 2, 2014, commencing at 9:02 a.m., before Chandra D. Brown, a

Registered Professional Reporter and Notary Public within and for the State of New York.

* * *

[40] Q So again, not using the full formal names, but there was essentially an '07 Special Asset Trust and an '09 Special Asset Trust?

A I believe that's correct.

Q And was – in each case it was essentially a pour-over? Like the 2009 Special Asset Trust, was that a pour-over of the 2007 Special Asset Trust?

A Yes, it was.

Q And the Kimberley Rice Kaestner Trust that was formed in the document that I believe is Exhibit 1, was that essentially all poured over into this new 2009 Trust?

A Yes, it was.

MR. MYRICK: You're referring to the special asset trust?

THE WITNESS: No. I'm sorry. I understood that to be the family trust.

MS. VINCENT: No. I had asked about the special asset trust and I was asking about just the Kimberley Rice Kaestner, but there was a 2007 –

MR. MYRICK: All right. You changed gears there. So I just wanted to be sure that was

* * *

[74] Q Have they shown an interest in the investments being of a certain type, such as green investments or socially responsible investments?

A We did not. I made it very clear to them that I was going to use my discretion, and I really didn't engage in discussions with them about investment managers, and they did not express an interest in my doing those kinds of investments and I didn't raise the issue with them either.

(Whereupon, the aforementioned document Bates stamped KRK0004154, was marked as Bernstein Exhibit 8 for identification as of this date by the reporter.)

BY MS. VINCENT:

Q Handing you what's been marked as Exhibit 8, its KRK4154, where Mr. Thomas is asking about what motivates Ms. Kaestner.

Did you or have you since then made a determination as to what motivates Ms. Kaestner?

A So here Barry is asking me if she would be interested in socially responsible investment. [75] And as I mentioned, there was – that was not something that – I could tell you that I don't even recall if we specifically asked her that question. It's possible. But, no, I don't – I don't have a – I don't think I know what motivates Ms. Kaestner from the perspective of what kind of investments interested her.

Q Do you believe that – is it Rocaton?

A Rocaton, yes, that's correct.

Q – that they have looked for investments that appeal to Ms. Kaestner?

A They have not. They looked for investments that appeal to me.

Q Why do you say that with such assurance?

A Because I've been – I have a very long history in investing, and I think that I have some sophistication in investing, and I've spoken with Rocaton a lot about my investment philosophy, and I let them know the types of investments that I was interested in. So I specifically directed them on the kinds of investments that I wanted for this Trust.

Q Are you aware that Mr. Kaestner is involved in various investment vehicles?

* * *

[79] Trust.

Q You're not aware of any issue that the Trust had in regard to a timing issue?

A The only timing issue that I think the Trust faced was the fact that if I didn't exercise my discretion prior to 2009 that the Trust assets would all be directed to Ms. Kaestner. And I'm going to be very careful here to try to avoid getting into privilege, but, as trustee, I told her that I thought it was inappropriate for the Trust to be distributed because the Trust provides very substantial creditor protection for her, and if these assets were in her own name, she would lose that creditor protection. And I did have conversations with

Ms. Kaestner about my intention to exercise my discretion to pour the Trust into a new trust that would not require me to distribute the assets to her at age 40.

That is a – to the extent the term "timing issue" covers that, that is certainly a topic that was on my mind. I don't know if that is – I don't know if that is what is referenced here, and I think that's the most I

* * *

[81] were going to bill for this work, because I know that we did not bill for a very substantial amount of the work that we did for Mr. Rice and for the trust.

We elected to write off and to heavily discount quite a lot of the work that we had done. And without seeing the full document, I don't know if this is an invoice that was actually sent or if this was an internal draft that we were working on before we decided what to bill. And I can't tell you who – if it was a bill, I can't tell you who it was billed to without seeing the cover page of bill itself.

Q Okay.

How often, and I apologize if you feel this is repetitive, but how often would you say that you ordinarily have communicated with the Kaestners?

A I believe I said infrequently, but I have given you my calendar records. It would tell you exactly every communication I've had with them.

Q So you believe that the –

A Excuse me. Well, every phone call or the

* * *

[83] would go months at a time without having any communications with them at all.

Q And in terms of accounting, not counting those three formal accountings but less formal accountings, just information on the status of the assets, how often would you say that occurs or has occurred?

A So, I mean, accounting, of course, is a term of art, which is what these binders are. If what you – I think what you're referring to is sort of, you know, how is the performance of Trust, and my view was that this was not something I wanted to share with them and so I did not regularly do that.

They had a report on the Trust investments in our 2007 meeting and I may have spoken with them, you know, very infrequently, maybe once a year, about how the Trust generally was doing, but it was not my practice to report to them the performance of the Trust on a regular basis.

Q Do you typically send them annual reports or quarterly reports that came from the investment vehicles that the Trust is involved [84] in?

A I did not.

(Whereupon, the aforementioned document Bates stamped KRK0004242, was marked as Bernstein Exhibit 10 for identification as of this date by the reporter.)

BY MS. VINCENT:

Q I've handed you what's been marked Exhibit 10. It's KRK4242.

A (Witness views document.)

Well, I think my counsel should have marked this as privileged personally. This is my seeking legal advice from Jonathan Rikoon.

THE WITNESS: And I will ask Tom to consider whether this should be privileged.

A But in any event –

MR. MYRICK: Wait. Before you answer any questions, let me just read it here.

Let's go off the record here. Let me confer with the witness about this document.

THE VIDEOGRAPHER: Time is 11:29 a.m. We are coming off the record.

(Whereupon, a short recess was taken.)

THE VIDEOGRAPHER: Time is 11:35 a.m. We

* * *

[88] investment decisions that I was making.

Q So in terms of getting the status of how the investment is doing, this is occurring how often?

A I probably gave them another report sometime in 2008, while the markets were in turmoil, but I can't

– I still think even after this period it was, you know, maybe once or twice a year at most.

Q In your opinion, do the Kaestners at this time have a reasonable idea of the size of their – of this asset?

MR. MYRICK: I'm going to object to the form of that question.

You can answer it.

THE WITNESS: Let me hear it again, please.

(Whereupon, the requested question was read back by the Court Reporter.)

A I'm not sure that they do.

MR. MYRICK: Same objection.

MS. VINCENT: I'm sorry?

MR. MYRICK: I just wanted to interject the objection after they read it back to him.

* * *

[ERRATA SHEET CONT'D] *** ERRATA SHEET ***

NAME OF CASE: THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST vs. NORTH CAROLINA DEPARTMENT OF REVENUE

DATE OF DEPOSITION: 5/2/14

NAME OF WITNESS: David H. Bernstein

Reason codes:

1. To clarify the record.
2. To conform to the facts.
3. To correct transcription errors.

Page 6	Line 21	Reason 1
From		to after trusts – add: shares into separate accounts
Page 7	Line 23	Reason 1
From		to after Trust – add: shares into separate accounts
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Page 19	Line 21	Reason 1
From in 2006		to from 2007
Page 20	Line 15	Reason 1
From		to add a period (.) after trust
Page 20	Line 16	Reason 1
From		to delete line 16

* * *

STATE OF NORTH CAROLINA	**IN THE GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION**
WAKE COUNTY	**12 CVS 8740**
The Kimberley Rice Kaestner 1992 Trust, Plaintiff, v. **North Carolina Department of Revenue,** Defendant.	**DEFENDANT'S REPLY TO PLAINTIFF'S RESPONSE AND REPLY TO MOTIONS FOR SUMMARY JUDGMENT** (Filed Oct. 21, 2014)

* * *

NORTH CAROLINA	IN THE GENERAL COURT OF JUSTICE
WAKE COUNTY	SUPERIOR COURT DIVISION
THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST, Plaintiff, v. N. C. DEPARTMENT OF REVENUE, Defendant.	No. 12-CvS-8740

DEPOSITION OF KIMBERLY RICE KAESTNER

TUESDAY, JUNE 24, 2014

Conference Room 3
Moore & Van Allen, PLLC
430 Davis Drive, Suite 500
Morrisville, North Carolina
1:00 p.m.

Volume 1 of 1

Pages 1 through 24

* * *

[14] A (interposing) Uh-huh.

Q – What type of information did you receive regarding the trust?

A So David – I first off met David. And my father was concerned that I have an understanding as to, you know, what the trust looked like, how it was invested, and met with a company called Rocaton that was handling the investments for David to get a better understanding as to what it looked like, because my father felt I should just – knowing that I wouldn't feel comfortable with the whole thing, that I should just understand what it looked like.

Q And after gaining that initial understanding, did you continue to receive information about the trust going forward?

A Yes.

Q From David?

A Yes.

Q From Rocaton?

A Yes.

Q From anyone else?

A I don't recall.

Q How often would you receive information?

A I don't recall.

Q Did you receive any kind of annual accountings on the trust?

[15] A Can you tell me more of what you mean?

Q I'm wondering if on a yearly basis you received a statement or other documents that told you that the health of the trust was –

A (interposing) Yes.

Q – at that time.

A Yes.

Q And who were those from?

A David.

Q Did you ever have occasion to call Mr. Bernstein's office to inquire about the trust?

A I don't recall.

Q When you met David and met Rocaton, where was that?

A In New York City.

Q Was that in David's office?

A It was at Debevoise & Plimpton, yes.

Q Was there a presentation given regarding the trust?

A Yes.

Q Who gave the presentation?

A People from Rocaton.

Q Have there been other meetings regarding the trust?

A What do you – what do you mean?

Q Other meetings maybe where something was going to be explained or presented or even just a short meeting with someone where they're giving you information on the trust.

* * *

[20] A Again, when it was set up as a trust, my understanding was my husband could say something to David or could give advice to David, but David could take or leave that advice as trustee.

I don't recall if my husband actually did that. He may have wanted to. I don't recall any exact conversation that they had. But it was my understanding as trustee that that judgment was ultimately David's.

Q Do you yourself have what I would call investment knowledge similar to your husband's?

A No.

Ms. Vincent: I have no further questions.

Mr. Myrick: Okay. Let's – let me talk to my client for a minute.

Mr. Silver: We can go off the record, take a short break.

The Reporter: Off the record. 1:25 p.m.

(A brief recess was taken.)

The Reporter: On the record. 1:31 p.m.

CROSS-EXAMINATION 1:31 p.m.

By Mr. Myrick:

Q is it your understanding that the plaintiff trust still exists today?

A Yes.

Q Okay. And the reason I ask that is because earlier

* * *

No. 18-457

In The Supreme Court of the United States

NORTH CAROLINA
DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST,

Respondent.

On Writ Of Certiorari To The Supreme Court Of North Carolina

PETITIONER'S BRIEF

ROBERT F. ORR
ROBERT F. ORR, PLLC
3434 Edwards Mill Rd.
Suite 112-372
Raleigh, NC 27612
(919) 608-5335

ANDREW H. ERTESCHIK
SAAD GUL
JOHN M. DURNOVICH
NATHANIEL C. ZINKOW
POYNER SPRUILL LLP
Post Office Box 1801
Raleigh, NC 27602
(919) 783-2895

JOSHUA H. STEIN
Attorney General

MATTHEW W. SAWCHAK
Solicitor General
Counsel of Record
JAMES W. DOGGETT
Deputy Solicitor General
RYAN Y. PARK
Deputy Solicitor General
NORTH CAROLINA
DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400
msawchak@ncdoj.gov

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

QUESTION PRESENTED

Does the Due Process Clause prohibit states from taxing trusts based on trust beneficiaries' in-state residency?

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INTRODUCTION

Kimberley Rice Kaestner is the beneficiary of a trust that her father created to transfer his wealth. During the tax years at issue in this case, Ms. Kaestner's trust generated millions of dollars of income. If the trust prevails here, however, it will avoid state income taxes on nearly all of that income.

That outcome is possible only because of a mistaken interpretation of the Due Process Clause. The North Carolina Supreme Court held here that when a trust's beneficiary lives in a state, that residency does not establish the connection with the state that due process requires.

That interpretation of the Due Process Clause results in a judicially created tax shelter.

Here, Ms. Kaestner's family skillfully exploited this tax shelter. The trust at issue had a trustee from Connecticut, a state that does not tax trusts under the circumstances here. Thus, the trust paid no income taxes in Connecticut.

In North Carolina, where Ms. Kaestner and her children lived, the trust did face state taxes, but it challenged the state's trust-tax statute on due-process grounds. The trust argued that North Carolina—the state where Ms. Kaestner lived, raised a family, and attended a state-funded university—lacked a "minimum connection" to her trust.

The North Carolina Supreme Court accepted the trust's arguments. It reasoned that Ms. Kaestner is a

mere "third party" to the trust that bears her name. On that theory, the court held that Ms. Kaestner's extensive North Carolina contacts did not count for due-process purposes. After concluding that the Kaestner Trust was not physically present in North Carolina, the court held that the Due Process Clause barred North Carolina from taxing the trust's income.

This *Pennoyer*-like formalism has no place in modern due-process doctrine. *See Pennoyer v. Neff*, 95 U.S. 714, 733–34 (1878). This Court's modern teachings on due process elevate fairness over formalism.

Under a fairness-based analysis, as well as settled principles of trust law, a beneficiary is the central figure in a trust. Serving the beneficiary's interests is the trust's reason for being. For these reasons, when a trust beneficiary lives in a state and benefits from the state's services, her trust has the required connection with that state.

Upholding taxes on that basis follows not only from modern due-process analysis, but also from federalism. This Court has long recognized the importance of the states' authority to tax. The due-process rule that the state supreme court adopted here, however, lays waste to the states' taxing authority. That rule invalidates a taxing approach that North Carolina has followed for almost a century.

The state supreme court's holding, moreover, creates a tax shelter that few large trusts will be able to resist. To avoid state income taxes under that holding, all one needs to do is select a trustee in a state

with no trust-income tax. Trusts in this country earn about 120 billion dollars of income every year. With that much income at stake, constitutionalizing a tax shelter would deal a serious blow to the fiscal health of many states.

Nothing in the Due Process Clause requires such a result. Under this Court's teachings, due process does not bar the states from taxing trusts based on a trust beneficiary's residency.

Because the state supreme court reached the opposite conclusion, its decision should be reversed. The tax shelter here deserves the same fate that befell a similar judicially created tax shelter last Term. *See South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2094 (2018).

OPINIONS BELOW

The opinion of the Supreme Court of North Carolina (Pet. App. 1a–26a) is reported at 814 S.E.2d 43 (N.C. 2018).

The opinion of the North Carolina Court of Appeals (Pet. App. 27a–40a) is reported at 789 S.E.2d 645 (N.C. Ct. App. 2016).

The state trial court's decision (Pet. App. 41a–69a) is available on Westlaw. *See Kimberley Rice Kaestner Family Trust v. N.C. Dep't of Revenue*, No. 12 CVS 8740, 2015 WL 1880607 (N.C. Super. Ct. Apr. 23, 2015).

JURISDICTION

The judgment below, affirming a final judgment on constitutional grounds, was entered on June 8, 2018. Pet. App. 1a. The petition for certiorari was filed on October 9, 2018, and granted on January 11, 2019. This Court has jurisdiction under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Due Process Clause of the Fourteenth Amendment provides that "[n]o State shall . . . deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend. XIV, § 1.

The North Carolina tax statute at issue states, in relevant part:

> The tax imposed by this Part applies to the taxable income of estates and trusts as determined under the provisions of the [United States Internal Revenue] Code except as otherwise provided in this Part. The taxable income of an estate or trust is the same as taxable income for such an estate or trust under the provisions of the [Internal Revenue] Code, [subject to certain adjustments]. The tax is computed on the amount of the taxable income of the estate or trust that is for the benefit of a resident of this State, or for the benefit of a nonresident to the extent that the income (i) is derived from North Carolina sources and is attributable to

> the ownership of any interest in real or tangible personal property in this State or (ii) is derived from a business, trade, profession, or occupation carried on in this State. . . . The fiduciary responsible for administering the estate or trust shall pay the tax computed under the provisions of this Part.

N.C. Gen. Stat. § 105-160.2 (2017).

STATEMENT

I. Background

Eleven states tax trusts, in whole or in part, based on trust beneficiaries' in-state residency.[1]

Before this lawsuit, North Carolina's trust-tax statute (or one of its predecessors) had been in force and unchallenged since 1923.[2] The statute taxes "the amount of the taxable income of [a] . . . trust that is for the benefit of a resident of" North Carolina. N.C. Gen. Stat. § 105-160.2 (2017).

II. The trusts at issue

In 1992, Joseph Lee Rice, III, created the Rice Family Trust to transfer wealth to his descendants. Pet. App. 2a. Mr. Rice referred to this trust as a "family asset." App. 51. He named his three children, including his daughter, Kimberley Rice Kaestner, as the trust's beneficiaries. Pet. App. 2a–3a.

Mr. Rice appointed William B. Matteson, a lawyer, as the Rice Family Trust's trustee. *See* Pet. App. 2a. Mr. Rice directed Mr. Matteson to distribute the trust's

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[1] Those states (besides North Carolina) are Alabama, *see* Ala. Code § 40-18-1(33); California, *see* Cal. Rev. & Tax. Code § 17742(a); Connecticut, *see* Conn. Gen. Stat. § 12-701(a)(4); Georgia, *see* Ga. Code Ann. § 48-7-22(a)(1)(A); Missouri, *see* Mo. Rev. Stat. § 143.331(1)(b); Montana, *see* Mont. Admin. R. 42.30.101(16); North Dakota, *see* N.D. Admin. Code 81-03-02.1-04; Ohio, *see* Ohio Rev. Code Ann. § 5747.01; Rhode Island, *see* 44 R.I. Gen. Laws § 44-30-5(c); and Tennessee, *see* Tenn. Code Ann. § 67-2-110(a).

[2] *See* Act of Mar. 3, 1923, ch. 4, § 205, 1923 N.C. Sess. Laws 67, 128.

assets "liberal[ly]" to "meet the needs of [the trust's] [b]eneficiaries." App. 51.

In 1997, Ms. Kaestner moved to North Carolina, where she and her husband raised a family. *See* Pet. App. 2a–3a.

In 2002, while Ms. Kaestner was living in North Carolina, the Rice Family Trust was divided informally into three separate shares. One of these three shares was for the benefit of Ms. Kaestner and her children. Pet. App. 3a.

In 2005, Mr. Matteson stepped down as the trustee of the Rice Family Trust. He was succeeded by David Bernstein, a lawyer at Debevoise & Plimpton LLP, the law firm that represents the Rice and Kaestner families. *See* Pet. App. 2a–3a; App. 41, 93.

Mr. Bernstein, by his own description, is "not a trust and estate lawyer." App. 92. Even so, he has another attribute that makes him a useful trustee: He is a resident of Connecticut, Pet. App. 2a, a state that does not tax trust income based on a trustee's residency alone.[3]

Soon after Mr. Bernstein became the trustee of the Rice Family Trust, he used Ms. Kaestner's share of that trust to form a new trust: the Kimberley Rice Kaestner 1992 Family Trust, the respondent in this case. Pet. App. 3a. The Kaestner Trust was established

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[3] *See* Conn. Gen. Stat. §§ 12-700(a)(10), 12-701(a)(4)(D)(i).

for the benefit of North Carolinians: Ms. Kaestner and her children. *See* Pet. App. 3a.[4]

The trust instrument names Ms. Kaestner and her children as the Trust's beneficiaries. Pet. App. 44a.[5] Throughout the tax years at issue, 2005 to 2008, these beneficiaries lived in North Carolina. Pet. App. 3a.

During the tax years at issue, Mr. Bernstein administered the Trust to satisfy Ms. Kaestner's needs. He and Ms. Kaestner communicated by phone, by e-mail, by mail, and in person. *See* App. 106; N.C. R. pp. 177, 217. At times, Mr. Bernstein and Ms. Kaestner would have "a number of calls in a couple weeks." N.C. R. p. 177.

On at least two occasions, Mr. Bernstein met with Ms. Kaestner in New York to discuss trust business. They discussed, among other topics, whether Ms. Kaestner wanted to receive distributions of her trust's income. Pet. App. 4a; App. 106.

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[4] From this point on, this brief uses the terms "the Trust" and "the Kaestner Trust" to refer to the Kimberley Rice Kaestner 1992 Family Trust. As far as the Department is aware, and as far as the record here shows, the same trust instrument that formed the Rice Family Trust also governs the Kaestner Trust. App. 44–75.

[5] The Trust has referred to Ms. Kaestner as its "sole primary beneficiary." Plaintiff-Appellee's Brief at 2, *Kimberley Rice Kaestner Family Trust v. N.C. Dep't of Revenue*, 814 S.E.2d 43 (N.C. 2018) (No. 307PA15-2). In references to the facts here, this brief uses the term "the beneficiary" to refer to Ms. Kaestner, unless the context requires a more specific reference.

Ms. Kaestner also received accountings in North Carolina on the financial status of her trust. *See* Pet. App. 4a.

During the tax years at issue, the assets of the Kaestner Trust totaled about thirteen million dollars. App. 118. Mr. Bernstein, however, did not make any distributions of trust income or trust principal during those years. Pet. App. 3a. Instead, the Trust accumulated income for Ms. Kaestner's benefit. *See* Pet. App. 3a–4a.

At some point between late 2008 and January 2009, Ms. Kaestner asked Mr. Bernstein for a loan from the Trust's assets, so she could pursue a commodities investment. *See* Pet. App. 3a; App. 99–100, 113. She received a loan of $250,000 from the Trust's assets in January 2009, the first month after the tax years at issue. Pet. App. 3a. Ms. Kaestner was a North Carolinian then as well. The Trust made the loan at the lowest interest rate that the IRS allows without imposing a gift tax. *See* Pet. App. 46a–47a.

In June 2009, Ms. Kaestner turned 40. Pet. App. 3a. The trust instrument provided that when Ms. Kaestner turned 40, the Trust would terminate and its assets would be distributed to her. Pet. App. 3a. Before Ms. Kaestner turned 40, however, she talked with her father and Mr. Bernstein about whether she should receive this distribution. Pet. App. 3a–4a. Ms. Kaestner ultimately decided that she would rather wait for the distribution. Pet. App. 3a–4a.

Following Ms. Kaestner's wishes, Mr. Bernstein did not distribute the assets of the Trust to Ms. Kaestner in 2009. Instead, he "decanted" most of those assets into yet another trust that was created for her benefit.[6] Pet. App. 4a.

III. The taxes on the Kaestner Trust

Over the tax years at issue, the Kaestner Trust and its predecessor trust sought to avoid state income taxes in every state that might have imposed such a tax.

The Rice Family Trust used Mr. Matteson as its first trustee. In 1995, Mr. Matteson moved to Florida. App. 11. Florida has no income tax, so the Rice Family Trust avoided all state income taxation there.

In 2005, the Florida trustee was replaced with Mr. Bernstein, a Connecticut resident. Pet. App. 2a. Connecticut does not tax trust income based on a trustee's residency alone. *See* Conn. Gen. Stat. §§ 12-700(a)(10), 12-701(a)(4)(D)(i). By having Mr. Bernstein serve as trustee, the Rice Family Trust and the Kaestner Trust avoided state income taxes in Connecticut.

They avoided most state income taxes in New York as well. After Mr. Bernstein became the trustee, he filed an amended trust-tax return for the Rice Family

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[6] Decanting a trust means distributing "some or all of a trust's assets to another trust." Amy Morris Hess, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* § 567, at 138 (Supp. 2018).

Trust in New York for 2005. That amended return invoked the Due Process Clause, stating that since Mr. Matteson's move to Florida in 1995, the Rice Family Trust "ha[d] been administered solely by a trustee domiciled outside the State of New York." App. 76. Mr. Bernstein went on to argue that the Rice Family Trust's "only contacts with [New York] in 2005 were the domicile of its [grantor] at the time the trust was created many years earlier and a negligible amount of income from intangible assets" in New York. App. 78.

Those due-process arguments relieved the Rice Family Trust from paying taxes on all of its income except $2,165 from New York sources. *See* App. 76–79. The trust's total income in 2005 was about $2,350,000. *See* App. 76–79. On virtually all of that income, the trust, by having Florida and Connecticut trustees, paid no state income taxes in New York.

In North Carolina, the Kaestner Trust sought to avoid state income taxes as well. Those efforts led to this lawsuit.

From 2005 through 2008, as noted above, the beneficiaries of the Kaestner Trust—Ms. Kaestner and her three children—were North Carolina residents. Pet. App. 3a–4a. The Trust earned millions of dollars of income during those years. Under North Carolina's trust-tax statute, that income generated a tax liability of about $1,280,000. The Trust paid these taxes under protest, then sued for a refund.

When the Trust sued North Carolina, it did not deny New York residency, as it had done in New York. Instead, in its North Carolina complaint, the Trust alleged that it was "a trust with a situs in New York." App. 9.

IV. The proceedings below

The Kaestner Trust brought this lawsuit as a constitutional challenge in state court.[7] Among its claims, the Trust asserted an as-applied challenge under the Due Process Clause of the Fourteenth Amendment. Pet. App. 4a–5a. In support of that challenge, the Trust alleged that it lacked a constitutionally sufficient connection with North Carolina. Pet. App. 4a–5a.

The state trial court concluded that North Carolina's assessment of taxes on the Trust violated the Due Process Clause.[8] Accordingly, the court ordered a refund of the taxes at issue. Pet. App. 69a.

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[7] The Tax Injunction Act, 28 U.S.C. § 1341 (2012), required Ms. Kaestner's Trust to file this lawsuit in state court. The Act provides that federal courts "shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State." *Ibid.*

[8] The Trust also pursued a Commerce Clause claim. The state trial court ruled in the trust's favor on that ground as well, holding that the court's due-process reasoning also showed a violation of the dormant Commerce Clause. Pet. App. 68a–69a. Neither of the state appellate courts addressed that part of the trial court's decision. *See* Pet. App. 7a–8a, 40a.

The North Carolina Court of Appeals affirmed. Pet. App. 27a.

In a 6-1 decision, the North Carolina Supreme Court affirmed the decision of the court of appeals. Pet. App. 2a. Applying the Due Process Clause, the court held that the in-state residency of trust beneficiaries is not a constitutionally sufficient connection with a state.

The court started its analysis by reasoning that a trust is an entity separate from its beneficiaries—in other words, that beneficiaries are third parties to a trust. Pet. App. 13a. Next, the court observed that third parties' contacts with a forum state do not count for due-process purposes. Pet. App. 13a. Finally, the court merged those two points and concluded that the North Carolina residency of the Kaestner Trust's beneficiaries does not establish any connection between the Trust and North Carolina. On that basis, the court held that North Carolina's trust-tax statute was unconstitutional as applied to the Trust. Pet. App. 18a.

Justice Sam J. Ervin, IV, dissented. In his opinion, he criticized the majority's "formalistic, presence-focused" analysis of due process. Pet. App. 24a. He opined that this Court's due-process decisions require a wider-ranging analysis of the Trust's connection with North Carolina—an analysis that gives weight to the in-state residency of the Trust's beneficiaries. Pet. App. 24a. Applying that analysis, Justice Ervin concluded that the Trust had a constitutionally sufficient

connection with North Carolina—a connection that brought the Trust within North Carolina's jurisdiction to tax. Pet. App. 24a.

SUMMARY OF ARGUMENT

The Due Process Clause does not bar a state from taxing a trust whose beneficiaries live in that state. Prohibiting those taxes, as the state supreme court did here, would harm the states in ways that the Due Process Clause does not compel.

To establish a due-process violation here, the Trust has the burden of satisfying two elements.

- First, the Trust must show that North Carolina lacks a "minimum connection" with "the person, property or transaction it seeks to tax." *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992) (quoting *Miller Bros. v. Maryland*, 347 U.S. 340, 344–45 (1954)).

- Second, the Trust must show that the "income attributed to the State for tax purposes" is not "rationally related to 'values connected with the taxing State.'" *Quill*, 504 U.S. at 306 (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978)).

Here, the Kaestner Trust cannot satisfy either of these elements.

First, Ms. Kaestner's residency in North Carolina establishes the required connection with the state.

The "minimum connection" standard centers on fairness, not formalism. *See infra* pp. 20–22. Indeed, this Court has specifically warned against using

"formalistic tests" to assess jurisdiction to tax. *Quill*, 504 U.S. at 30.

Under a fairness-based analysis, a trust has the required connection with a taxing state when a trust beneficiary lives in that state. A trust, after all, is not a distinct entity like a corporation. Instead, it is just an abstraction that describes a fiduciary relationship between people. *See Americold Realty Tr. v. Conagra Foods, Inc.*, 136 S. Ct. 1012, 1016 (2016).

Because a trust has no entity status, the state supreme court erred by demanding connections between the Kaestner Trust "itself" and North Carolina. Pet. App. 18a. For purposes of due-process connections with the states, a trust has no "self."

Instead, the only way a trust can make contact with a state is through the trust's constituents—the grantor, the trustee, and the beneficiary. That conclusion follows not only from trust law, but also from *Greenough v. Tax Assessors*, 331 U.S. 486 (1947), and *Americold*, 136 S. Ct. 1012. *See infra* pp. 25–28.

Out of the three constituents in a trust, trust beneficiaries have the most important jurisdictional contacts. Under trust law, the beneficiary is the central figure in the trust relationship—the trust's reason for being. *See infra* pp. 29–30. As these points show, the state supreme court erred by treating Ms. Kaestner as a "third party" to the trust that bears her own name.

Once formalism is cast aside, the analysis here becomes simple. Ms. Kaestner and her children lived in North Carolina throughout the tax years at issue. North Carolina offered them wide-ranging protection and services—benefits that spared the Trust from having to pay for equivalent services. Those benefits and protections made it only fair for North Carolina to demand a return in the form of trust-income taxes. *See infra* pp. 34–37.

For all these reasons, North Carolina has far more than a "minimum connection" with the Kaestner Trust. The state's connection with the Trust satisfies the first element under *Quill*.

The tax here also satisfies the second element under *Quill*. The tax was "rationally related to values connected with" North Carolina. *Quill*, 504 U.S. at 306. One hundred percent of the Trust's income during the years at issue was earned for the benefit of North Carolinians.

In sum, due process does not justify the doctrine that the Trust seeks here: a rule that the only state that can tax trust income is the state where a trustee lives.

That rule would construct a "judicially created tax shelter" of the first magnitude. *Wayfair*, 138 S. Ct. at 2094. If that rule became the law, any rational grantor would choose a trustee in a state without trust-income taxes. That choice, moreover, would not require much effort: Trust companies and online services stand ready to assign favorably located trustees.

These tax-reducing strategies are far from hypothetical. In this case, the Rice and Kaestner families used similar strategies. The families' trusts worked with trustees in Florida and Connecticut, states with no applicable trust-income taxes.

Trusts generate 120 billion dollars of our nation's income every year. In view of that figure, an endorsement of the tax shelter the Trust seeks here would harm the fiscal health of many states. *See infra* pp. 41–43.

For these reasons and others, the Due Process Clause does not mandate the judicially created tax shelter that the Kaestner Trust is seeking.

ARGUMENT

I. The Due Process Clause does not prohibit a state from taxing a trust with beneficiaries in that state.

A. The two-part test in *Quill* governs the due-process analysis here.

As the Framers recognized, the states have always had "an independent . . . authority to raise their own revenues for the supply of their own wants." The Federalist No. 32, at 197 (Alexander Hamilton) (Clinton Rossiter ed., 1961).

The states' authority to tax is a cornerstone of federalism. As Chief Justice Marshall noted in *McCulloch v. Maryland*, "the power of taxing the people and their property, is essential to the very existence of government." 17 U.S. (4 Wheat.) 316, 428 (1819). This power covers "[a]ll subjects over which the sovereign power of a state extends." *Id.* at 429.

Acting on these principles of federalism, this Court has cautioned that the "modes adopted [by the states] to enforce the taxes levied should be interfered with as little as possible." *Dows v. City of Chicago*, 78 U.S. (11 Wall.) 108, 110 (1871).

This Court's modern case law on tax jurisdiction embraces these principles of federalism. As recently as last Term, the Court described state taxes as a "valid exercise of the States' sovereign power." *Wayfair*, 138 S. Ct. at 2096.

In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the Court applied the Due Process Clause consistently with the above principles. The Court held that, in a due-process challenge to a tax, the taxpayer must satisfy two elements. *Id.* at 306.

First, the taxpayer must show that the taxing state lacks even a "minimum connection[] between [the] state and the person, property or transaction it seeks to tax." *Ibid.* (quoting *Miller Bros.*, 347 U.S. at 345).

Second, the taxpayer must show that the "income attributed to the State for tax purposes" is not "rationally related to 'values connected with the taxing State.'" *Quill*, 504 U.S. at 306 (quoting *Moorman*, 437 U.S. at 273).

Both of these tests center on "fundamental fairness." *Quill*, 504 U.S. at 312. To test for fairness, this Court asks whether the state's exercise of jurisdiction is related to the benefits and protections that the state has provided—that is, "whether the state has given anything for which it can ask [for taxes in] return." *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 24–25 (2008) (quoting *ASARCO Inc. v. Idaho Tax Comm'n*, 458 U.S. 307, 315 (1982)).

This fairness-based analysis has replaced the rigid, presence-focused analysis that prevailed in the years after *Pennoyer*, 95 U.S. 714. In *Quill*, the Court eliminated the "physical presence" rule under the Due Process Clause. *Quill*, 504 U.S. at 308. The Court also

warned against using other "formalistic tests" to assess jurisdiction to tax.[9] *Id.* at 307.

Just last Term, the Court underscored these principles in *Wayfair*, 138 S. Ct. 2080. The Court reaffirmed *Quill*'s holding that a taxpayer "need not have a physical presence in a state to satisfy the demands of due process." *Id.* at 2093 (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985)). The

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[9] This shift away from presence-based tests parallels developments in the area of jurisdiction to adjudicate. *See, e.g.*, *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 319 (1945); *see also Daimler AG v. Bauman*, 134 S. Ct. 746, 761 n.18 (2014) (noting this shift in adjudicative-jurisdiction doctrine).

Although tax jurisdiction parallels adjudicative jurisdiction in many respects, the two are not identical. *See Quill*, 504 U.S. at 319–20 (Scalia, J., concurring). As Justice Scalia discussed in *Quill*, tax jurisdiction resembles prescriptive jurisdiction: a state's power "to make its law applicable to the activities, relations, or status of persons, or the interests of persons in things." Restatement (Third) of Foreign Relations Law § 401 (Am. Law Inst. 1987); *see Quill*, 504 U.S. at 319–20 (Scalia, J., concurring). Adjudicative jurisdiction, in contrast, describes a state's power "to subject persons or things to the process of its courts or administrative tribunals, whether in civil or in criminal proceedings, whether or not the state is a party to the proceedings." Restatement (Third) of Foreign Relations Law § 401.

Because adjudicative jurisdiction and tax jurisdiction play different roles, one should take care before applying precedents from one sphere in the other sphere. *Cf.* Pet. App. 13a, 17a (relying extensively on *Walden v. Fiore*, 571 U.S. 277 (2014), and *Hanson v. Denckla*, 357 U.S. 235 (1958), decisions on adjudicative jurisdiction).

Here, there is no dispute over adjudicative jurisdiction, because Ms. Kaestner's Trust sued the Department in North Carolina's courts.

Court also condemned "arbitrary, formalistic" distinctions that lower courts had used to "prevent States from collecting taxes." *Wayfair*, 138 S. Ct. at 2092.

Through these decisions, the Court has repeatedly cautioned that a proper due-process analysis of taxation centers on fairness, not formalism. That movement away from formalism is especially important in this case.

B. Under the Due Process Clause, a trust beneficiary's contacts with a state justify taxing her trust.

1. For due-process purposes, a trust is an abstraction, not a distinct legal entity.

Here, the state supreme court reasoned that for the Kaestner Trust to have a constitutionally valid connection with North Carolina, the connection would have to involve the "trust itself." Pet. App. 18a. The court's reasoning overlooked this Court's analysis of the relationship between states and trusts.

American law has traditionally refused to recognize a trust as "a distinct legal entity." *Americold*, 136 S. Ct. at 1016.

Instead, this Court has described a trust as an "abstraction." *Greenough v. Tax Assessors*, 331 U.S. 486, 493 (1947) (quoting *Anderson v. Wilson*, 289 U.S. 20, 27 (1933)). That description reflects the reality that a

trust is "not a legal person." Amy Morris Hess, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* § 712, at 273 (2009) [hereinafter Bogert]; *cf. Taylor v. Davis' Adm'x*, 110 U.S. 330, 335 (1884) ("[t]he trust estate cannot promise").

In *Americold*, the Court clarified the nature of a trust. 136 S. Ct. at 1016. The Court explained that a trust is merely a "'fiduciary relationship' between multiple people."[10] *Ibid.* (quoting Restatement (Second) of Trusts § 2 (1957)); *accord* Restatement (Third) of Trusts § 2 (Am. Law Inst. 2012).

That fiduciary relationship begins when the grantor of an irrevocable trust contributes property to the trust. Unif. Trust Code § 103 (Unif. Law Comm'n 2000); Bogert, *supra*, § 1, at 8–10. The people in the fiduciary relationship itself are the trust beneficiary and the trustee. Bogert, *supra*, § 1, at 11.

The beneficiary is the person for whose benefit the trustee holds the trust property. *Ibid.* "The trustee is the individual or entity (often an artificial person such as a corporation) that holds the trust property for the benefit of [the beneficiary]." *Id.* at 7. These two people—in some cases, multiple people—are the ones who make up the trust relationship. *Americold*, 136 S. Ct. at 1016.

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[10] Because of the abstract nature of a trust, *Americold* held that a real-estate-investment trust does not have a distinct entity-level citizenship for purposes of diversity jurisdiction. 136 S. Ct. at 1016.

When the North Carolina Supreme Court applied due-process analysis here, it misunderstood how that analysis applies to trusts. The court treated the Kaestner Trust as a separate legal entity. Pet. App. 12a. Taking this "separate entity" theory further, the court held that, for due-process purposes, Ms. Kaestner is a "third party" to her trust. Pet. App. 13a. The court cited *Brooke v. City of Norfolk*, 277 U.S. 27 (1928), for the proposition that a trust and its beneficiaries are separate for tax purposes. Pet. App. 12a–13a.

That "separateness" theory was rejected, however, in *Stone v. White*, 301 U.S. 532 (1937). There, in the context of a tax-refund claim, this Court equated trusts' interests with beneficiaries' interests. The Court held that when a trust pays a tax, "only [the beneficiary] is ultimately burdened." *Id.* at 538. Thus, the Court refused to "shut its eyes to the fact that in the realm of reality it [is] the beneficiary's money which [pays] the tax." *Id.* at 535.

When the state supreme court held that Ms. Kaestner is a mere third party to her trust, the court also cited *Hanson v. Denckla*, 357 U.S. 235 (1958). *Hanson*, however, does not control here. The issue there was adjudicative jurisdiction over a *trustee*, not tax jurisdiction over a trust. *Id.* at 253. The *Hanson* Court had no occasion to decide whether a beneficiary's residency in a state allows that state to tax the beneficiary's trust income.

Based on these and other errors, the state supreme court treated a trust beneficiary as a stranger to the trust that bears her name. That kind of formalism has no place in a modern due-process analysis, which centers on fairness. *See supra* pp. 20–22. Under a fairness-based analysis, it makes no sense to limit the inquiry to the jurisdictional contacts of a mere abstraction.

2. The contacts that count for due-process purposes are the contacts of a trust's constituents.

Because a trust is an abstraction, it cannot have physical contacts with a state. *See Americold*, 136 S. Ct. at 1016 (noting that the "[trust] relationship was not a thing that could be haled into court"). Instead, a trust makes jurisdictional contact with states through the people who make up the trust relationship.

The Court established this principle in *Greenough v. Tax Assessors*, 331 U.S. 486 (1947). There, the Court considered a question closely related to the question here: whether the Due Process Clause barred Rhode Island from taxing a trust based on the in-state residency of a trustee. *See id.* at 488–89. The Court held that the Due Process Clause did not bar such a tax. *Id.* at 498.

The *Greenough* Court began by analyzing the unique, abstract nature of trusts. *Id.* at 493. The Court pointed out that it has treated a trust as an abstraction, not as a separate entity. *Ibid.*

The federal tax code sometimes treats a trust as a separate taxpayer, but the Court described that treatment as a statutory decision, not as a constitutional command. *Id.* at 493–94 ("This is because Congress has seen fit so to deal with the trust.").

In contrast, when the Court assessed the jurisdictional contacts of the trust in *Greenough*, the Court did not treat the trust as a taxpayer with a "separate existence." *Id.* at 493. Instead, the Court focused on the jurisdictional contacts of the trust's *constituents*. *Id.* at 496.

Because of the facts in *Greenough*, the constituent at issue was a trustee. *Id.* at 488. In that context, the Court held that a benefit to a trustee is a benefit to the trust abstraction itself. *Ibid.* Because of the unique relationship between a trust and its constituents, the Court recognized that a trustee's contacts with a state can justify taxing a trust. *Id.* at 496. Through that reasoning, the *Greenough* Court treated a trust and its constituents as inextricably intertwined.[11]

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[11] The same conclusion also flows from one of this Court's key decisions on adjudicative jurisdiction: *Burger King Corp. v. Rudzewicz*, 471 U.S. 462. There, the Court held that the nature and intensity of a relationship can justify a court's exercise of power over a person. *Id.* at 480.

The relationship between a beneficiary and her trust is far more intensive than the franchise relationship at issue in *Burger King*. A beneficiary is not a contractor with a trust; she is the trust's very heart. As shown below, the trust cannot exist without her. *See infra* pp. 29–30.

Greenough's approach is significant, because that decision departs from a *Pennoyer*-era decision on the due-process limits of trust taxation. *See Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929).

In *Safe Deposit*, the Court held that Virginia could not assess property taxes on trust property that was being held in Maryland for a Virginia beneficiary. *Id.* at 94. *Safe Deposit* applied a rigid, *Pennoyer*-era due-process test—one that turned on the literal taxpayer's "actual presence" in the taxing state. *Id.* at 92.

The taxpayer at issue in *Safe Deposit* was a trust. *Id.* at 90. Under *Pennoyer*-era reasoning, once the Court decided that the trust property itself was not physically present in the taxing state, the case was over. *Ibid.* The Court expressly declined to consider whether, in light of the trust relationship, the contacts of the trust's beneficiaries should count for due-process purposes. *See id.* at 92 ("We need not make any nice inquiry concerning the ultimate or equitable ownership of the [trust property] or the exact nature of the interest held by the [beneficiaries].").

Greenough—a case decided a generation after *Safe Deposit* and two years after *International Shoe*—shows how the Court's analysis of trust contacts has turned away from formalism. In *Greenough*, the Court did what it declined to do in *Safe Deposit*: It examined the nature of the trust relationship, rather than

focusing on the literal taxpayer's physical presence. *See Greenough*, 331 U.S. at 493. By performing that analysis, the Court showed that the contacts of the people in the trust relationship count in a due-process analysis.

When one compares *Greenough* with *Safe Deposit*, it becomes clear that one decision involves a modern due-process analysis, and one does not. *Greenough*, with its emphasis on fairness, tracks a modern due-process analysis. *Safe Deposit*, with its formalistic, presence-based reasoning, clashes with this Court's modern teachings on due process.[12] *See supra* pp. 20–22 (discussing those teachings).

In the related context of adjudicative jurisdiction, this Court has cautioned that *Pennoyer*-era precedents "should not attract heavy reliance today." *Daimler*, 134 S. Ct. at 761 n.18. Discarding *Safe Deposit* and upholding *Greenough* would reinforce that caution.

In sum, the analysis here should follow the central point of *Greenough*: In trust-tax cases, the contacts of the people in the trust relationship are the contacts that matter.

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[12] *Safe Deposit* is no longer good law for another reason as well: It is premised on the view that the Due Process Clause prohibits double taxation. 280 U.S. at 92. The Court later abandoned that view in *Curry v. McCanless*, 307 U.S. 357, 363 (1939). *See, e.g., Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 803 (Conn. 1999) (noting that concerns over double taxation were "[c]entral to the Court's reasoning in *Safe Deposit*," but that those concerns had "long been abandoned as a limitation on taxation under the due process clause").

3. A trust beneficiary is a constituent of a trust—indeed, the most important constituent.

As shown above, *Greenough* holds that trustees' in-state residency justifies state taxes on trusts.

That conclusion applies with even greater force when the state resident at issue is a trust beneficiary. As shown below, a beneficiary is not only another constituent of a trust; she is a trust's most important constituent. Because of a beneficiary's central role in a trust, her residency in a state forms the required link between the taxing state and the trust. *See Quill*, 504 U.S. at 327 (requiring such a link).

The beneficiary is a trust's reason for being. Under settled principles of trust law, a trust exists solely "for the benefit of its beneficiaries." Unif. Trust Code § 404 (Unif. Law Comm'n 2000). The trust abstraction is simply "incidental to and derivative of the purpose of benefiting the trust beneficiary." Kent D. Schenkel, *Trust Law & the Title-Split: A Beneficial Perspective*, 78 UMKC L. Rev. 181, 183 (2009). Indeed, a trust cannot exist without beneficiaries. *See* Restatement (Third) of Trusts § 44 (Am. Law Inst. 2012).

A trust beneficiary, moreover, has an ownership interest in trust property—a "right, title, and estate in and to" that property. *Commonwealth v. Stewart*, 12 A.2d 444, 447 (Pa. 1940), *aff'd mem.*, 312 U.S. 649 (1941). In contrast, a trustee's interest in trust property is "merely nominal, with real ownership

remaining in the beneficiary." John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 Yale L.J. 165, 181 (1997).

As these points show, a beneficiary is not just one of the people in the trust relationship; she is the *most important* person in that relationship.

4. The benefits and protections that states give a trust beneficiary justify taxing her trust.

Because of the central role that a beneficiary plays in a trust, the principle of *Greenough* applies equally to this case. Under that principle, a trust constituent's residency in a state connects the trust to the state. *See Greenough*, 331 U.S. at 495; *see also McCulloch v. Franchise Tax Bd.*, 390 P.2d 412, 419 (Cal. 1964) (same); *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 802 (Conn. 1999) (same).

Another principle in *Greenough* applies here as well: The benefits and protections that a state gives a trust constituent justify taxing the trust.

In *Greenough*, the Court pointed out that the trust constituent at issue, the trustee, was "entitled to the same advantages from Rhode Island laws as [was] any natural person there resident." 331 U.S. at 495.

The Court also stressed the many benefits and protections that Rhode Island gave the trustee. The state offered the trustee all of the "benefits and protection inherent in the existence of an organized

government," including the "privileges of citizenship" and "the protection of his domiciliary government." *Id.* at 493.

The Court held, moreover, that it did not matter whether the trust constituent actually used these benefits; all that mattered was that he had the opportunity to do so. *See ibid.* The Court upheld the tax at issue even though "nothing appeared as to any specific benefit or protection which the trustee had actually received." *Id.* at 495.

The benefits and protections that a state offers a trust beneficiary are even more important than the benefits that a state offers a trustee. *See id.* at 493–97 (citing those benefits).

The fulfillment of a trust's purpose—serving the trust beneficiary—"assumes solvent state and local governments." *Wayfair*, 138 S. Ct. at 2096. That purpose depends on the benefits that a state confers by maintaining "an orderly, civilized society." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940).

For example, if a beneficiary's home state did not protect "sound local banking institutions," a trust could not make secure distributions to the beneficiary. *Wayfair*, 138 S. Ct. at 2096 (quoting *Quill*, 504 U.S. at 328). More fundamentally, if the beneficiary did not receive the physical protection and security that her state government provides, including the "police and fire departments that protect [her]," she would be in no position to receive or enjoy her distributions. *Wayfair*, 138 S. Ct. at 2096; *see also* Ilya Somin, *Revitalizing*

Consent, 23 Harv. J.L. & Pub. Pol'y 753, 759 (2000) (describing the enormously expensive services that states provide).

Indeed, state benefits and protections relieve a trust from making outlays on its beneficiaries' behalf. For example, a common purpose of a trust is to pay for beneficiaries' education. Restatement (Third) of Trusts § 50 cmt. d(2) (Am. Law Inst. 2012). All states, however, offer free public schools to their school-age residents. Because a state offers that expensive service for free, a trust that has a duty to provide for the education of its beneficiaries need not spend thousands of dollars per year on private schools. Free education and other taxpayer-subsidized benefits allow a trust to save its income and garner investment returns.

The privileges that flow from a beneficiary's in-state residency "are inseparable from responsibility for sharing the costs of government." *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 313 (1937). As Justice Holmes famously observed, "taxes are what we pay for [a] civilized society." *Compania Gen. de Tabacos de Filipinas v. Collector of Internal Revenue*, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting).

This close relationship between state taxation and state protection of trust beneficiaries has led other state courts to uphold state trust taxes against due-process claims.

In *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, for example, the Connecticut Supreme Court drew the same parallel to *Greenough* that this brief draws. *See*

supra pp. 30–31. The court held: "[J]ust as the state may tax the undistributed income of a trust based on the presence of the trustee in the state because it gives the trustee the protection and benefits of its laws[,] it may tax the same income based on the domicile of the sole noncontingent beneficiary because it gives her the same protections and benefits." *Id.* at 802 (citing *Greenough*, 331 U.S. at 496).

Likewise, in *McCulloch v. Franchise Tax Board*, 390 P.2d 412, the California Supreme Court agreed that a beneficiary's home state can tax undistributed trust income. The court emphasized the protection that a state offers a trust during the years when the trust is accumulating income. During those years, the state gives the beneficiary "the interim protection of its laws so that [she] may ultimately obtain the benefit of the accumulated income." *Id.* at 419.

As these courts rightly held, a trust beneficiary's residency in a state gives her, and her trust, enormously valuable services and protection. Those services, plus the close connection between the beneficiary and the trust, establish the required connection between the state and the trust. *See Quill*, 504 U.S. at 306. That principle decides this case.

C. Ms. Kaestner's residency in North Carolina justifies the state's exercise of tax jurisdiction over her trust.

As shown above, the Trust's due-process challenge to North Carolina's trust-tax statute is governed by the

two-part test that this Court announced in *Quill*. *See Quill*, 504 U.S. at 306; *supra* p. 20.

The statute satisfies both parts of the *Quill* test.

1. Ms. Kaestner's North Carolina residency satisfies the first element of *Quill*.

As applied to the Kaestner Trust, North Carolina's trust-tax statute satisfies the first element of the *Quill* test, the "minimum connection" element. As shown above, when a trust beneficiary lives in a state, so does her trust. Here, the beneficiaries of the Kaestner Trust were North Carolina residents during the tax years at issue.

As in-state residents, Ms. Kaestner and her children were offered all of the taxpayer-funded benefits and protections that come with residency in North Carolina. These benefits and protections parallel the benefits that, *Greenough* held, would justify the exercise of tax jurisdiction over a trust. 331 U.S. at 493–97; *supra* pp. 30–31.

Indeed, the case for taxation here is even stronger than in *Greenough*. There, the Court noted that the record did not show "any specific benefit or protection" that any trust constituent had actually received. *Greenough*, 331 U.S. at 495. Here, in contrast, Ms. Kaestner received wide-ranging benefits and protections from North Carolina. In fact, those state benefits replaced services that the Trust otherwise would have had to buy for Ms. Kaestner.

For example, one of the Trust's purposes was "to provide for [its beneficiaries'] education." App. 51. North Carolina gave Ms. Kaestner the opportunity to send her children to the state's excellent public schools at no charge. Indeed, the North Carolina Constitution secured the children's right to a free education in the public schools. N.C. Const. art. I, § 15 ("The people have a right to the privilege of education, and it is the duty of the State to guard and maintain that right."); *id.* art. IX, § 2(1) (mandating "free public schools").

Similarly, before the tax years at issue, Ms. Kaestner enrolled at the University of North Carolina at Chapel Hill and earned a master's degree. App. 81. North Carolina's taxpayers subsidized that public university. *See* N.C. Gen. Stat. §§ 116-4, -144. During the tax years at issue, if Ms. Kaestner wished to pursue further studies in the UNC system, those educational services were available to her at taxpayer-subsidized rates. *See* App. 81.

Another one of the Kaestner Trust's main purposes was to provide for the beneficiaries' health and welfare. App. 51. North Carolina shouldered that responsibility by giving Ms. Kaestner and her children all of the critical public-safety services needed to protect their health and welfare, including police and fire departments. *See Wayfair*, 138 S. Ct. at 2096. By taking on those responsibilities, North Carolina relieved the Trust of the enormous expense that equivalent services would have required.

The trust instrument also directed the trustee to help Ms. Kaestner if she "set[] up a business." App. 51. When Ms. Kaestner did so, North Carolina's state government stepped in again to help the Trust. Near the end of the tax years at issue, the Trust loaned Ms. Kaestner $250,000 to invest in commodities. Pet. App. 3a. That loan was facilitated by North Carolina's sound local banking institutions. *See Wayfair*, 138 S. Ct. at 2096. If the loan had generated any legal disputes, North Carolina's state courts and state laws were at hand to resolve those disputes. *See Greenough*, 331 U.S. at 495–97 (citing the availability of a state's legal system as a benefit to a trust).

In these ways and more, North Carolina benefited the Kaestners by maintaining the "orderly, civilized society" that made their lifestyle in North Carolina possible. *J.C. Penney*, 311 U.S. at 444.

In view of those benefits, as well as the inseparable relationship between Ms. Kaestner and her trust, her life in North Carolina establishes the required "minimum connection" between North Carolina and the Trust. That connection satisfies the first element under *Quill*.

2. North Carolina's limited tax satisfies the second element of *Quill*.

This case also satisfies the second element of *Quill*: North Carolina's taxation of the Trust's income was "rationally related to values connected with" the

state. *Quill*, 504 U.S. at 306 (quoting *Moorman*, 437 U.S. at 273).

The state supreme court did not reach this issue. *See* Pet. App. 10a ("[I]n this case we are concerned only with the first [*Quill*] requirement."). Even so, the record makes clear that the tax at issue satisfies the second element under *Quill*.

North Carolina taxed Ms. Kaestner's Trust only on income that was earned for Ms. Kaestner's benefit. North Carolina's statute taxes only "the amount of the taxable income . . . that is for the benefit of a resident of this State." N.C. Gen. Stat. § 105-160.2. That narrowing language ensures that North Carolina's trust taxes are apportioned to match the interests held by North Carolina beneficiaries.

Here, 100 percent of the Trust's income during the years at issue was earned for the benefit of North Carolinians. The Trust's own complaint alleged that, during the tax years at issue, the Trust's "current beneficiaries" were "Kimberly Rice Kaestner and her three children, all of whom were residents and domiciliaries of North Carolina." App. 11. Thus, the share of the Trust's income that was connected with North Carolinians—and therefore connected with state services to those North Carolinians—was 100 percent. That was the share of the Trust's income that North Carolina taxed. *See Moorman*, 437 U.S. at 269.

* * *

For these reasons, North Carolina's trust-tax statute, as applied to the Kaestner Trust, satisfies both elements of the *Quill* test. By reaching the opposite conclusion, Pet. App. 18a, the state supreme court made an error of federal constitutional law.

II. The Due Process Clause does not mandate the tax shelter that the Trust seeks here.

As shown above, when trust beneficiaries live in a taxing state, taxing trust income comports with due process. That conclusion becomes even clearer when one considers the harmful effects of the opposite rule that the state supreme court applied here. That rule is no better than a judicially created tax shelter—a type of doctrine that this Court has not hesitated to reject.

A. This case presents an opportunity for the Court to reject a judicially created tax shelter.

In the recent *Wayfair* decision, the Court condemned "judicially created tax shelter[s]" in the context of sales taxes. *Wayfair*, 138 S. Ct. at 2094. This case presents an opportunity for the Court to close an equally undesirable tax shelter: one that shelters massive trust income from state taxes.

In 2014 alone, trusts filed more than 2.7 million federal tax returns. Collectively, those trusts reported income of more than 120 billion dollars.[19]

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[19] *See* Internal Revenue Service, SOI Tax Stats—Fiduciary Returns—Sources of Income, Deductions, and Tax Liability—Type of Entity: 2014, *available at* https://www.irs.gov/statistics/soi-tax-stats-fiduciary-returns-sources-of-income-deductions-and-tax-liability-by-type-of-entity. This figure includes returns filed on behalf of complex trusts, simple trusts, grantor trusts, qualified-disability trusts, split-interest trusts, and pooled-income funds. It does not include returns filed on behalf of

Taxes on these billions of dollars are a critical source of funding for states' essential government services. At least eleven states currently tax undistributed trust income when a trust beneficiary lives in the taxing state. *See supra* p. 6 n.1.

The result the Trust seeks here, however, would make it possible for trusts to shelter their entire undistributed income from state income taxes. To achieve that result, all a trust would need to do is select a trustee in a state that does not tax trust income based on the trustee's residency—for example, Connecticut, where Mr. Bernstein lived, or Florida, where the predecessor trustee lived. *See supra* p. 10.

After selecting such an out-of-state trustee, beneficiaries like Ms. Kaestner could live in their home states, consume state resources, and accept other protections from the state on a tax-free basis.

Indeed, the ruling that the Kaestner Trust seeks would allow beneficiaries to avoid paying state income taxes forever. Beneficiaries like Ms. Kaestner could accumulate income in their trusts over several decades, avoid taxes on that income, and then, before taking a distribution from their trusts, simply move to a state without income taxes.

This tax shelter, if endorsed by this Court, would create an opportunity that few trusts could resist. As scholars agree, trusts are "particularly well suited" for

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decedents' estates, Chapter 7 bankruptcy estates, and Chapter 11 bankruptcy estates.

"fiscal and regulatory avoidance." Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. Rev. 434, 479 (1998).

Unlike a human being, a trust can change its situs instantaneously. *See* Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom*, 85 Cornell L. Rev. 1035, 1065 (2000). For example, "[f]or a California trust to relocate to Alaska, no individual has to change her domicile. A trust can relocate to Alaska without the use of bricks or mortar." *Ibid.*

Indeed, in this age of widespread online services, technology has made it remarkably easy to select a trustee in a state with no trust-income tax.[14] If a trust has an existing trustee in a state with unfavorable tax laws, a beneficiary can simply "request that the trustee resign." Jay A. Soled & Mitchell M. Gans, *Asset Preservation and the Evolving Role of Trusts in the Twenty-First Century*, 72 Wash. & Lee L. Rev. 257, 277 n.129 (2015).

Because of these options, "mov[ing] an income-accumulation trust from a high income tax state to a low income tax state" is now "[o]ne of the most significant reasons for moving the situs of [an existing]

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[14] For example, Charles Schwab Trust Company offers trustee services, promising to "leverag[e] the advantages of a favorable trust situs" in Nevada, a state that does not tax trust income. Charles Schwab Trust Company, https://www.schwab.com/public/schwab/investing/accounts_products/personal_trust_services (last visited Feb. 20, 2019).

trust." John Warnick & Sergio Pareja, *Selecting a Trust Situs in the 21st Century*, 16 Probate & Property 53, 57 (2002).

These techniques have led sophisticated planners to view trusts as "an income tax savior." Soled & Gans, *supra*, at 280. Empirical studies have shown that record amounts of assets have started flowing into trusts. *See* Robert Sitkoff & Max Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 Yale L.J. 356, 391 (2005). A study that tracked the aggregate assets in trusts from 1985 through 2003 showed an increase from 400 billion dollars to 1.2 trillion dollars. *See ibid.*

In sum, the rule of constitutional law that the Trust seeks here would endorse "an extraordinary stratagem by which wealthy individuals are able to avoid all state income taxes on investment income through the use of a carefully crafted out-of-state trust." Jeffrey Schoenblum, *Strange Bedfellows: The Federal Constitution, Out-of-State Nongrantor Accumulation Trusts, and the Complete Avoidance of State Income Taxation*, 67 Vand. L. Rev. 1945, 1997 (2014).

Such a rule would also end the states' ability to adopt tax approaches that would combat this tax-avoidance technique. Sound principles of federalism counsel against such a result. *See Dows*, 78 U.S. at 110 ("[The] modes adopted [by the states] to enforce the

taxes levied should be interfered with as little as possible.").

Finally, constitutionalizing the tax shelter at issue here would deprive the states of hundreds of millions of dollars in tax revenue annually—losses that could reach a billion dollars in North Carolina over the next decade alone. Pet. 13.

Just last Term, this Court struck down a similar tax shelter, expressing concern over the "significant revenue losses to the States" that the tax shelter posed. *Wayfair*, 138 S. Ct. at 2093–94. The same ruling is justified here.

B. The Trust has actively sought to exploit the tax shelter at issue.

The facts of this case are a graphic example of the tax avoidance that would be produced by the rule the Trust seeks here.

During the tax years at issue, Ms. Kaestner expressed alarm to her trustee, Mr. Bernstein, about the number of expensive lawyers who were working to optimize her trust arrangements. N.C. R. p. 225. Mr. Bernstein reassured her that the legal fees would be "immaterial compared to the major tax savings" that the lawyering would achieve. N.C. R. p. 225.

If the Trust prevailed here, that outcome would prove Mr. Bernstein right.

As noted above, the predecessor of the Kaestner Trust, the Rice Family Trust, used a Florida trustee for

a decade.[15] Florida has no income tax, so the trust avoided state income taxes in Florida during those years.

In 2005, the Florida trustee was replaced by a Connecticut trustee, Mr. Bernstein. Pet. App. 2a. Connecticut does not tax trust income based on a trustee's residency alone.[16] Thus, the Rice Family Trust avoided state taxes in Connecticut as well.

Having avoided taxes in Connecticut, Mr. Bernstein then challenged New York's jurisdiction to tax the Rice Family Trust's income. He invoked the Due Process Clause, arguing that the trust lacked sufficient connections to New York. App. 76–79. On that basis, the trust avoided any residency-based taxes in the Empire State. Instead, it reported only $2,165 in income from New York sources—less than 0.1% of the trust's income that year. App. 76–79.

In North Carolina, in contrast, the Kaestner Trust faced a more significant challenge to its tax-avoidance efforts. North Carolina assessed income taxes on the Trust, because the Trust's beneficiaries lived in North Carolina and had access to extensive state services. *See supra* pp. 34–36.

To resist those taxes, the Trust filed this lawsuit. Although Mr. Bernstein had argued a few years earlier that the Trust's predecessor had insufficient

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[15] Mr. Matteson, the original trustee, moved to Florida in 1995. App. 11.

[16] *See* Conn. Gen. Stat. §§ 12-700(a)(10), 12-701(a)(4)(D)(i).

connections with New York, he argued to the North Carolina courts that the Kaestner Trust was "a trust with a situs in New York." App. 9.

Those tactics, so far, have enabled the Kaestner Trust and its predecessor to avoid state income taxes on virtually all of their income during the years described above.

During these years of maneuvering, there was one constant: North Carolina remained home to Ms. Kaestner, the beneficiary of the trust that bears her name.

If the Trust prevails here, it will have benefitted from Ms. Kaestner's consumption of North Carolina's services for years, yet will have avoided paying any trust-income taxes to fund those services. That outcome would clash with the "traditional notions of fair play and substantial justice" that shape modern analysis under the Due Process Clause. *International Shoe*, 326 U.S. at 320.

CONCLUSION

The state supreme court's decision should be reversed.

Respectfully submitted,

ROBERT F. ORR
ROBERT F. ORR, PLLC
3434 Edwards Mill Rd.
Suite 112-372
Raleigh, NC 27612
(919) 608-5335

ANDREW H. ERTESCHIK
SAAD GUL
JOHN M. DURNOVICH
NATHANIEL C. ZINKOW
POYNER SPRUILL LLP
Post Office Box 1801
Raleigh, NC 27602
(919) 783-2895

JOSHUA H. STEIN
Attorney General

MATTHEW W. SAWCHAK
Solicitor General
Counsel of Record
JAMES W. DOGGETT
Deputy Solicitor General
RYAN Y. PARK
Deputy Solicitor General
NORTH CAROLINA
DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400
msawchak@ncdoj.gov

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No. 18-457

IN THE

Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST,

Respondent.

ON WRIT OF CERTIORARI TO
THE SUPREME COURT OF NORTH CAROLINA

BRIEF FOR THE RESPONDENT

THOMAS DEAN MYRICK
MOORE & VAN ALLEN PLLC
100 North Tryon Street
Charlotte, N.C. 28202
704-331-1126
tommyrick@mvalaw.com

DAVID A. O'NEIL
Counsel of Record
ANNA A. MOODY
LAURA E. O'NEILL
DEBEVOISE & PLIMPTON LLP
801 Pennsylvania Ave. N.W.
Washington, D.C.
(202) 383-8000
daoneil@debevoise.com

Counsel for Respondent

QUESTION PRESENTED

May a State assert jurisdiction over a nonresident trustee based solely on the fact that a contingent beneficiary resides in that State?

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INTRODUCTION

This case concerns North Carolina's attempt to exercise jurisdiction over a person with whom it has no contacts. That person, a nonresident trustee, did not engage in any conduct purposefully availing himself of North Carolina, and the State disavows any argument to the contrary. Instead, the State seeks to base jurisdiction on a single fact: that a different person, a contingent trust beneficiary, happened to reside there.

Relying on that fact alone, the State taxed the nonresident trustee on the worldwide income of the trust property. The State imposed that tax even though the beneficiary was unaware of the trust for most of its existence, did not meet the trustee until halfway through the four-year tax period, and neither received nor was entitled to any trust income during the years involved.

All of the North Carolina courts rejected the State's assertion of power as a violation of fundamental principles of due process. Those decisions are correct and should be affirmed.

This Court has twice addressed and resolved the question presented, including in the foundational case of *Hanson v. Denckla*, 357 U.S. 235 (1958). There, the Court held that a State may not assert jurisdiction over a nonresident trustee based solely on the fact of a beneficiary's forum residence. That case resolves this one. The same result follows from the core principles this Court has applied in evaluating due process limits on state jurisdiction under *International Shoe Co. v. Washington*, 326 U.S. 310 (1945), and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

The State asks the Court to ignore the precedents that govern this case. Instead, the State justifies its jurisdictional overreach with exaggerated and misplaced policy concerns about the impact of the decision below on tax revenues. In reality, States have ample means of taxing trust income in ways that the decision below does not affect. At issue here is a highly unusual tactic that very few States have even attempted.

Ultimately, North Carolina's grievance is not that the States lack constitutional power to tax, but rather that the States with constitutional power to tax have chosen not to exercise it. That disagreement with the policy decisions of voters in other States does not grant North Carolina license to expand its jurisdiction beyond settled constitutional bounds.

STATEMENT OF THE CASE

I. THE TRUSTEE OWNED AND CONTROLLED THE TRUST PROPERTY, AND THE BENEFICIARIES HAD NO VESTED RIGHT TO TRUST ASSETS

The trust in this case was created in 1992 by a written agreement between a New York settlor and a New York trustee. The agreement granted the trustee ownership of the trust property and absolute discretion to control all trust matters, including investments and distributions. The beneficiaries were third parties to that agreement, with no present right to trust income or principal nor any guarantee that they would ever receive either.

A. The Agreement Between the Settlor and Trustee Granted the Trustee Absolute Discretion over the Trust Property

The settlor established the trust when he executed an agreement with the trustee "assign[ing], transfer[ring], and convey[ing] to the trustee" all of the trust property. App. 45. A non-grantor trust in the traditional common law model, the trust was "irrevocable and unamendable by the Settlor." Art. 10, App. 69. The settlor retained no control over the transferred assets.

Instead, the agreement bestowed "absolute discretion" over the administration and disposition of the trust property on the trustee. Art. 1 §§ 1.1, 1.2, 1.4, App. 45–46, 50–51. The trustee was empowered to "do all such acts, take all such proceedings and exercise all such rights and privileges . . . with respect to any such property, as if the absolute owner thereof and in connection therewith to make, execute and deliver any instruments and to enter into any covenants or agreements binding any trust hereunder." Art. 5 § 5.2(r), App. 60. Under the agreement, the trustee would make distributions of assets only "as the Trustee in the Trustee's absolute discretion may from time to time determine." Art. 1 § 1.1, App. 46. The trustee was also entitled to terminate the trust "at any time in [his] discretion." Art. 2, App. 51–52.

B. The Beneficiaries Did Not Own or Control the Assets and Were Not Guaranteed Ever to Receive a Distribution

The trust agreement conferred no property or authority on the beneficiaries, who were defined only as "a class of persons consisting of the Settlor's

descendants, whenever born." Art. 1 § 1.1(a), App. 45. In addition to that class of contingent primary beneficiaries, the trust identified as secondary beneficiaries the settlor's spouse and sister. App. 52.

Because the trustee had sole and absolute discretion over trust administration, the beneficiaries could not compel distributions of any income or principal for any reason, including for financial support or for their health, education, or welfare. Art. 1, App. 44–46, 51. To guide the trustee's discretion, the trust agreement identified certain milestones that might warrant distributions, Art. 1 § 1.4, App. 50–51, but the power to make decisions about when, whether, and how to distribute trust property remained solely with the trustee. *Id.*

The trust agreement explicitly prohibited the beneficiaries from alienating or assigning trust property. Art. 12, App. 70–71. The beneficiaries' creditors could not reach trust assets, even upon the death of the beneficiaries, because the trust agreement prevented a beneficiary from appointing the balance of her interest to her estate creditors prior to termination. Art. 1 § 1.2(c)(2)(i), App. 47–48. The beneficiaries were not provided the right to influence, or even to receive notice of, investment decisions.

Any particular contingent beneficiary, moreover, was not guaranteed ever to receive any funds from the trust. The trustee was specifically empowered to pay some or all trust property to any one member of the contingent beneficiary class to "the exclusion of other [beneficiaries] in such manner as the Trustee may deem advisable." Art. 1 § 1.4, App. 50. Thus, although the trust contemplated distribution of

assets to each of the settlor's descendants as they reached age 40, Art. 1, § 1.2(c)(1), App. 47, by that time the trustee could have distributed the entire trust to other beneficiaries. In addition, New York law permitted the trustee to exercise his discretion not to distribute on the beneficiary's fortieth birthday and instead to decant the assets into a new trust without the termination provision. N.Y. Est. Power & Tr. Law § 10-6.6(b); App. 96.

Ultimately, the contingent beneficiaries' only right with respect to the trust property was standing to sue. If a beneficiary disagreed with the trustee's decisions, she could bring an equitable action in New York alleging that the trustee abused his discretion. Restatement (Third) of Trusts § 50 (Am. Law Inst. 2003) ("A discretionary power conferred upon the trustee to determine the benefits of a trust beneficiary is subject to judicial control only to prevent misinterpretation or abuse of the discretion by the trustee."). Such a suit would face a formidable standard, requiring a showing of "abuses that are arbitrary or the result of bad faith." *Haynes v. Haynes*, 900 N.Y.S. 2d 22, 22 (N.Y. App. Div. 2010).

II. THE TRUSTEE HAD NO CONTACTS WITH NORTH CAROLINA

From its creation, the trust agreement and property had nothing to do with North Carolina. The trustee had no connection with that State, before or after the contingent beneficiary moved there.

A. The Trust Agreement, Trust Property, Settlor, and Trustees Had No North Carolina Contacts

The settlor and initial trustee were both residents and domiciliaries of New York. App. 39. They

executed the trust agreement in New York, App. 75, and specified that it was subject to New York law. Art. 10, App. 69.

None of the trust property was located in North Carolina, and none of the trust income was derived directly from a North Carolina source. App. 41–42. The trust assets did not include any real property, in North Carolina or elsewhere. App. 41. The custodian of the trust assets was located in Massachusetts. *Id.* Other ownership documents and records were kept in New York. *Id.*

The initial trustee moved to Florida in 1995 and continued to administer the trust until he retired in 2005. App. 39. The settlor then appointed as trustee David Bernstein, who remained in that position during the relevant period. App. 39–41. Bernstein, who paid the tax at issue, was a resident and domiciliary of Connecticut when the settlor appointed him and throughout the relevant tax years. App. 40–41.[1]

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[1] The trust agreement contemplated an initial term of 10 years, after which the trustee would divide the trust into separate shares for each of the settlor's then-living children, or if deceased, the children's then-living descendants. Art. 1 §§ 1.1, 1.2, App. 45–46. In 2002, the initial trustee informally divided the trust into three separate sub-trusts. App. 91. Bernstein formalized the division into separate trusts, including the named respondent here. App. 92. The same trust agreement continued to govern. Art. 1 § 1.2, App. 46.

B. The Trustee and Trust Property Had No Contacts with North Carolina as a Result of the Beneficiary's Residence

In 1997, five years after the trust's creation, one of the settlor's children, Kimberley Kaestner, moved to North Carolina. App. 11. During the tax years at issue, Ms. Kaestner, a contingent beneficiary, lived with her family in that State. *Id.*

For 10 years after she moved to North Carolina, and for the first 15 years the trust existed, Ms. Kaestner had no contact at all with the trustee. App. 84–86. The initial trustee and Ms. Kaestner were literal strangers; they never met or interacted. App. 83. Indeed, Ms. Kaestner did not even know that the trust existed when she moved to North Carolina. App. 84. She did not learn about the trust until nearly a decade later, in 2006—the second of the four tax years at issue—and her first meeting with Bernstein about the trust was not until 2007 in New York. App. 121, 106–07.

For the rest of the tax period, the trustee's interactions with Ms. Kaestner were "very infrequent[]." App. 127. He did not regularly inform her about the trust's performance, nor did he send her annual or quarterly reports about its status. *Id.*

There is no support for the State's incorrect assertion that the trustee "administered the Trust to satisfy Ms. Kaestner's needs." Pet. Br. 8.[2] In fact,

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[2] The State mischaracterizes the record in several respects to portray inaccurately the interactions between trustee and beneficiary. It states, for example, that the trustee met with Ms. Kaestner "[o]n at least two occasions." Pet. Br. 8. As the North Carolina Supreme Court explained, "[t]he undisputed

(continued)

the trustee met with Ms. Kaestner only twice: once in 2007 and once in 2008. App. 106–07. Both meetings took place in New York and consisted of purely informational reports to educate Ms. Kaestner about the trust. App. 103–04. At no point did the trustee seek or accept investment input from Ms. Kaestner or any other beneficiary. App. 42. The trustee had no further meetings with the beneficiary during the tax years and, until this suit was filed, never traveled to North Carolina in his trustee capacity. App. 106–07.

Before Ms. Kaestner turned 40 in June 2009, after the tax years in dispute, the trustee exercised his discretion under New York law to decant the trust property into a new trust rather than distribute the assets. App. 96–97.

The trustee never distributed any of the trust income at issue here to Ms. Kaestner or any other North Carolina beneficiary during the tax period. App. 43.

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evidence in the record shows that contact between Bernstein and Kaestner regarding administration of the trust was infrequent—consisting of only two meetings during the tax years in question." Pet. App. 17(a).

Similarly, the State incorrectly asserts that the trustee made a loan to Ms. Kaester "[n]ear the end of the tax years at issue." Pet. Br. 36. As the North Carolina Supreme Court noted, that loan was made in 2009, after the tax period. Pet. App. 3(a). That court correctly concluded that "[a]ny connection between plaintiff and North Carolina based on the loan is . . . irrelevant given that the loan was issued in January 2009, after the tax years at issue." Pet. App. 17(a); *see also* App. 113 (noting that the loan was in 2009).

III. NORTH CAROLINA TAXED THE TRUSTEE ON ALL OF THE TRUST INCOME, AND ALL OF THE NORTH CAROLINA COURTS HELD THE TAX UNCONSTITUTIONAL

North Carolina taxed the trustee on the worldwide income of the trust for the years 2005 to 2008, even though none of that income had been generated in North Carolina or received by a North Carolina resident. The sole basis for the tax was the fact that a contingent trust beneficiary lived there during those years, triggering a statute requiring "the fiduciary responsible for administering the . . . trust [to] pay" tax on the income of the trust property "that is for the benefit of a resident of this State." N.C. Gen. Stat. § 105–160.2 (2017).

The trustee paid under protest and then brought suit in the name of the trust challenging the constitutionality of the tax. All of the North Carolina courts held that the tax violated both the Due Process Clause of the Fourteenth Amendment and the North Carolina Constitution.

The North Carolina Business Court invalidated the tax primarily on the basis of *Quill*, 504 U.S. 298, and the minimum-contacts analysis that case prescribes. The court noted the State's agreement that "the only connection" supporting the tax "is the residence of the beneficiaries." Pet. App. 54a. Premising jurisdiction on that single fact, the court reasoned, failed for a number of reasons. That theory contradicted the fundamental principle that "[t]he focus of the due process inquiry must be on the entity being called upon to pay taxes," *id.* at 51a, and instead "conflat[ed] the beneficiaries' contact[s]" with those of the taxpayer. *Id.* at 54a. Moreover, the

court noted, the State's argument "ignores the undisputed facts that [the beneficiaries] had no control over [trust] assets or ability to generate income from those assets, and had no authority to compel [the trustee] to distribute income." *Id.* at 55a.

The court therefore concluded that the State lacked the minimum connection necessary to justify the tax. The court further held that *Quill* invalidated the tax for the similar reason that the taxed income bore no rational relationship with the State. *Id.* at 58a. In addition, the court reasoned that the tax failed Commerce Clause scrutiny on multiple grounds, including that "the mere presence of the beneficiaries" was not a "substantial nexus" with that State for a tax on undistributed trust income. *Id.* at 65a, 67a–68a.

The Court of Appeals unanimously affirmed the Business Court, concluding that "North Carolina did not demonstrate the minimum contacts necessary to satisfy the principles of due process." Pet. App. 27a. That conclusion rested on the same observations that drove the Business Court's holding and on this Court's decisions addressing due process limits on taxation of trust income. *Id.* at 38a–40a. The Court of Appeals deemed it unnecessary to reach the Commerce Clause.

The North Carolina Supreme Court affirmed. Like the lower courts, that court considered whether the State could tax the trust income "solely based on the North Carolina residence of the beneficiaries during the tax years." Pet. App. 2a. The court reasoned that, under *Quill*'s requirement of a "minimum connection[—]more commonly referred to as minimum contacts"—the taxpayer's "minimum

contacts with the taxing state cannot be established by a third party's" actions. *Id.* at 10a, 13a. Applying this Court's cases elaborating on due process guarantees, the North Carolina Supreme Court concluded that "[w]hen, as here, the income of a foreign trust is subject to taxation solely based on its beneficiaries availing themselves of the benefits of our economy and the protections afforded by our laws, those guarantees are violated." *Id.* at 18a.

One justice dissented. Even that justice, however, did not adopt the State's argument that the fact of a beneficiary's residence alone supports jurisdiction. Instead, the dissenting justice agreed that the "proper due process analysis focuse[s] upon the activities of" the trustee in light of the beneficiary's residence, which is "relevant, but not dispositive." Pet. App. 24a–25a & n.2. Thus, not a single judge in the North Carolina system who reviewed this case agreed with the State's position.

The State sought certiorari limited to the "narrow question" of whether the challenged tax is justified based "solely on the presence of an in-state beneficiary." Pet. Rep. in Supp. of Cert. 6–7 ("[T]his case is an ideal vehicle: It presents the beneficiary's in-state residency in clean form, allowing the Court to resolve the question presented without the need to consider other types of jurisdictional contacts.").

SUMMARY OF ARGUMENT

North Carolina's exercise of jurisdiction over a nonresident trustee with no connection to the State, based solely on the fact that a contingent beneficiary lived there, violates the Due Process Clause.

I. This Court has twice addressed and decided the question presented, and those precedents control here.

A. As part of a series of decisions on the constitutional limits of trust taxation, this Court held that the State where a beneficiary resided could not, on that basis alone, tax a nonresident trustee on trust property the resident beneficiary neither received nor controlled. *Safe Deposit & Tr. Co. v. Virginia*, 280 U.S. 83 (1929). That decision rested on practical considerations of actual control and ownership, and it aligns with the principles of fundamental fairness that animate contemporary due process cases. The State's effort to dismiss *Safe Deposit* as based on the physical location of the taxed property mischaracterizes its reasoning and ignores its central place in a principled, practical, and fair framework for defining the outer bounds of state jurisdiction to tax trust property.

B. This Court reached the same conclusion in *Hanson v. Denckla*, 357 U.S. 235 (1958), a pillar of due process jurisprudence. In *Hanson*, the Court held that a State may not assert jurisdiction over a nonresident trustee based solely on the forum residence of beneficiaries. Focusing on the trustee's own actions, the Court articulated the requirement of "purposeful availment" that remains the constitutional touchstone. The Court specifically refused to attribute a beneficiary's forum contacts to the trustee, reasoning that "[t]he unilateral activity of those who claim some relationship with a nonresident . . . cannot satisfy the requirement of contact with the forum State." *Id.* at 253.

Hanson is not distinguishable in any material respect. There is no practical difference between asserting jurisdiction over the trust property and asserting jurisdiction over the trustee who owns the trust property. And state jurisdiction to tax is informed by the same principles governing jurisdiction to adjudicate. *Hanson*'s reasoning and result control this case, and unless this Court repudiates both, North Carolina cannot prevail here.

II. The due process principles elaborated in this Court's subsequent decisions confirm the holding of *Safe Deposit* and *Hanson* and invalidate the North Carolina tax.

A. Due process requires minimum contacts between the State and the taxpayer and a rational relationship between the tax and fiscal values connected to the State. *Quill*, 504 U.S. 298.

Under this Court's decisions, the focus of the minimum-contacts inquiry must be the taxpayer's own conduct. The State does not argue that the taxpayer engaged in any conduct by which he purposefully availed himself of North Carolina. Instead, the State supports jurisdiction solely by pointing to a different person's conduct—the decision of a contingent trust beneficiary to live there. That argument fails: a nonresident's relationship with a forum resident, without more, cannot establish the necessary minimum connection. Similarly, taxing the trustee for the worldwide income of the trust based on the possibility that a contingent beneficiary might someday receive it in North Carolina does not qualify as the rational fiscal relationship that *Quill* requires.

B. The State principally contends that the forum contacts of any one "trust constituent" are attributable to anyone else in the trust relationship, including the trustee. But this Court's precedent and the distinct roles of trustees and beneficiaries under basic tenets of trust law foreclose the State's effort to fuse them for jurisdictional purposes. And what the State decries as the "separateness theory" of trust constituents is a consequence of North Carolina's own law, which treats the trustee and beneficiary as independent actors who cannot bind one another.

C. Jurisdiction over the trustee cannot rest on the ground that the State provided public services to the beneficiary. This Court has previously rejected that argument, which, like the State's main theory, focuses on the wrong party and does not show that the *trustee* purposefully availed himself of the forum.

The argument also assumes facts that are not true. The State claims that the beneficiary consumed state resources without paying taxes in return, but in fact, she did pay taxes on all income she had actually received and enjoyed during the tax years. She had not received—and might never have received—income of a trust she did not control and did not know existed, and there is no basis to treat that income as if it were hers. Similarly, the State asserts that the protections it provided the beneficiary spared the trustee from having to furnish equivalent services. In truth, the trustee had no obligation to provide the beneficiary anything in the tax years other than the good-faith exercise of his absolute discretion.

The State's public-benefits argument is boundless. It would permit jurisdiction over the trustee not just

in any State where a contingent beneficiary resides, but also in any State that, because the beneficiary spent time there, could claim to have provided her the interim protections of its laws.

D. The existence of a fiduciary relationship with a forum resident does not create jurisdiction over the trustee wherever any beneficiary decides to move. This Court has repeatedly held that assuming a role with fiduciary obligations to a resident does not constitute purposeful availment. The circumstances of this case demonstrate why the State's argument is incorrect. The trustee and beneficiary were literal strangers for the first 15 years of the trust's existence, and their interactions thereafter were "very infrequent[.]" App. 127.

III. Misplaced policy concerns about the impact of the decision below on state tax revenues do not justify the State's jurisdictional overreach. Those concerns are greatly exaggerated. States have ample means of taxing trust income unaffected by the ruling below. States make individual decisions about whether to tax trust income within their jurisdiction, and those choices reflect considered judgments about tax policy. Limits on state jurisdiction are a consequence of federalism, which promotes and respects the sovereign right of each State to set its tax policy without interference from other States that lack a legitimate interest. North Carolina's jurisdiction does not expand because it disagrees with the policy choices of other States to refrain from exercising their constitutional power.

ARGUMENT

I. THIS COURT'S DECISIONS RESOLVE THIS CASE AND COMPEL THE HOLDING BELOW

This Court's decisions foreclose North Carolina's attempt to exercise jurisdiction over a taxpayer with no forum contacts. Cases decided specifically in the context of trust taxation have already addressed and rejected the State's position. And the foundational minimum-contacts case of *Hanson v. Denckla* confirms the correctness of the Court's previous decisions in the *International Shoe* framework.

A. *Safe Deposit* and Its Corollary Decisions Invalidate the North Carolina Tax

The Court has resolved the question presented as part of a series of decisions that establish common-sense and fair due process limits on trust taxation. Under those decisions, a State may tax a resident trustee for property he owns, and it may tax a resident beneficiary for property she receives or controls. A State may not, however, tax a nonresident trustee for no reason other than the residence in the State of a beneficiary who has not received and lacks possession or control of the trust property.

1. This Court has rejected the tax North Carolina imposed

In *Brooke v. City of Norfolk*, 277 U.S. 27 (1928), this Court considered whether a State may tax a resident beneficiary on the assets of an out-of-state trust. The trust was created by the will of a Maryland citizen conveying the trust property to a Maryland trustee for the benefit of the Virginia-resident petitioner and her descendants. The petitioner had paid Virginia "without question a tax

upon the income received by her," but she challenged Virginia's power to tax her for the undistributed Maryland trust property. *Id.* at 28.

The Court held the tax unconstitutional on the basis of fundamental principles of fairness. The premise of the attempted tax, the Court observed, was "that the petitioner is chargeable as if she owned the whole" trust, and not just the income she actually received. *Id.* Rejecting that premise, the Court contrasted the petitioner's situation with that of a taxpayer who "actually us[ed]" the property. *Id.* at 29. Here, the Court explained, "the property is not within the State, does not belong to the petitioner and is not within her possession or control. The assessment is a bare proposition to make the petitioner pay upon an interest to which she is a stranger. This cannot be done." *Id.*

One year later, the Court addressed the corollary question to *Brooke*, which is also the question presented in this case: If the State may not tax a resident beneficiary on undistributed out-of-state trust property, may the State tax an out-of-state trustee on the sole ground that the beneficiary is a resident? Considering the same realities of actual control and ownership underlying *Brooke*, the Court held that such a tax offends due process. *Safe Deposit*, 280 U.S. 83.

The trust property in *Safe Deposit* was held by a Maryland trustee for the benefit of the settlor's two Virginia-resident sons. Under the trust agreement, the trustee was to own the property until distribution of half of the assets to each son as he reached 25. Although neither son had yet received any distribu-

tions, Virginia taxed the Maryland trustee based on the fact of the beneficiaries' Virginia residence.

This Court invalidated the Virginia tax on the trustee as a violation of the Due Process Clause, focusing on the practical realities of the trust relationship. Under the doctrine that intangible property follows its owner, the Court reasoned, Virginia could as a general matter assert jurisdiction over trust property even though it was located outside the State's territorial borders. That general rule applied, however, only if it aligned with reality—only if, as the State contended, the beneficiaries "really owned the [trust] fund." *Id.* at 91.

In truth, the Court recognized, the State's argument "plainly conflict[ed] with fact"; the beneficiaries did not own the trust assets and "no person in Virginia ha[d] present right to their enjoyment or power to remove them." *Id.* at 92. Because "nobody within Virginia ha[d] present right to their control or possession, or to receive income therefrom, or to cause them to be brought physically within her borders," the Court held that Virginia lacked jurisdiction to tax the trust assets through the nonresident trustee. *Id.* at 91.

The Court distinguished previous cases that had permitted taxation by highlighting practical differences in true ownership and control. In those other cases, the Court reasoned, the resident had either "full power to control the deposits" or "control and present right to all benefits arising from the property"; "[t]he legal title was not held by another with the duty to retain possession, as in the present cause." *Id.* at 94. The Court thus concluded that taxation of a nonresident trustee based solely on the

forum residence of a beneficiary "would result in inescapable and patent injustice," violating the principles of fairness the Due Process Clause protects. *Id.* at 92.[3]

As this description illustrates, there is no merit to Petitioner's effort to dismiss *Safe Deposit* as beholden to a "rigid" *Pennoyer*-based rule of "physical presence." Pet. Br. 27–28. *Safe Deposit* relied on the same "traditional notions of fair play and substantial justice" that continue to animate due process jurisprudence. The Court did *not* reject Virginia's exercise of jurisdiction because the trust property was physically located outside of the State's border. Quite the contrary, the Court noted that it could—and ordinarily would—uphold jurisdiction based on the intangibles-follow-the-owner fiction even though the property was not physically present

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[3] The State seizes on references in *Safe Deposit* to "double taxation" in an effort to cast that decision as resting on outdated concerns. In fact, this Court had already held more than a decade before—in a case *Safe Deposit* specifically cited—that the Due Process Clause does not categorically forbid "double taxation." *See Fidelity & Columbia Tr. Co. v. City of Louisville*, 245 U.S. 54, 58 (1917) ("[L]iability to taxation in one State does not necessarily exclude liability in another.").

The Court's driving concern in *Safe Deposit* was instead that the attempted tax was "double and oppressive" because it would permit any State in which a beneficiary or trustee lived to tax the whole trust as a resident. That concern remains just as vital today and independently dooms the North Carolina tax under the Commerce Clause. *See Comptroller of the Treasury of Md. v. Wynne*, 135 S. Ct. 1787, 1795 (2015) (holding that the Constitution prohibits a state tax scheme that risks "double taxation of income earned out of the State" in a manner that disfavors interstate activity).

in the State. The Court rejected that fiction precisely because it "plainly conflict[ed] with fact": the beneficiaries did not really own the trust property, nor did they own, control, or actually receive any trust income.[4]

The State's characterization of *Safe Deposit*'s reasoning—that "once the Court decided that the trust property itself was not physically present in the State, the case was over"—is simply wrong. Pet. Br. at 27. In fact, the reasoning in *Safe Deposit* reflects the "highly realistic" approach that this Court has prescribed for due process inquiries. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 479 (1985).

2. *Safe Deposit* is part of a fair, principled, and practical due process framework

Brooke and *Safe Deposit* form part of a fairness-based framework for constitutional jurisdiction in the trust taxation context. Complementing those decisions, and completing the principles they established, is an additional pair of cases confirming that States may assert jurisdiction when doing so aligns with the reality of actual ownership and control of trust property.

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[4] Similarly, there is no merit to *amicus*' argument that the result in *Safe Deposit* and *Brooke* depended on the particular type of tax involved. *See* Brief for Tax Law Professors at 16–18. In both cases, the Court concluded that the tax was unconstitutional because it attributed to the beneficiaries ownership of intangible property that was not actually theirs, and to which they were "a stranger." *Brooke*, 277 U.S. at 29. That rationale has nothing to do with whether the tax is on principal or instead on income.

First, in *Guaranty Trust Co. v. Virginia*, 305 U.S. 19 (1938), the Court held that Virginia could tax a resident beneficiary on income she actually received from an out-of-state trust. *Id.* at 23; *see also Maguire v. Trefry*, 253 U.S. 12 (1920). Rejecting the beneficiary's Due Process Clause challenge, the Court relied on decisions upholding taxes imposed on income to those who actually "recei[ved] and enjoy[ed]" it. *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 281 (1932) (permitting taxes on "the economic interest realized by the receipt of income or represented by the power to control it"); *New York ex. rel. Cohn v. Graves*, 300 U.S. 308, 312 (1937) (noting that the petitioner actually "received" the taxed funds "as a part of her income in the tax years").

Second, in *Greenough v. Tax Assessors of Newport*, 331 U.S. 486 (1947), the Court upheld a tax on a resident trustee for trust property he legally owned. Although the beneficiary, the other trustee, and the records were elsewhere, the Court again focused on ownership and control, reasoning that the State could tax the resident trustee because "the intangibles are subject to [his] immediate control" and the State "offer[s] benefit and protection through its law to the resident trustee as the owner of intangibles." *Id.* at 493, 496. The Court cited and specifically distinguished *Safe Deposit* on the ground that, in that case, the trust assets were "actually in the hands of the nonresident trustee and not subject to the control" of the resident beneficiary. *Id.* at 496.

The State relies heavily on *Greenough*, attempting to portray it as a repudiation of *Safe Deposit* and a fundamental shift in reasoning. This, too, is a

mischaracterization. *Greenough* did not endorse a nebulous inquiry permitting the State to blend "the contacts of people in the trust relationship," such that the jurisdictional contacts of any one person in that relationship can be attributed to any other. Pet. Br. 28. To the contrary, *Greenough* followed the same path marked by *Brooke*, *Safe Deposit*, and *Guaranty Trust*, focusing on the particular person whom the State sought to tax and evaluating whether the realities of *that* person's circumstances supported jurisdiction. That focus remains a central requirement of due process. *See infra* pp. 32–33; *Walden v. Fiore*, 571 U.S. 277, 284 (2014) (forum contacts must be those of the "defendant *himself*"). In *Greenough*, the Court upheld jurisdiction because the person with forum contacts owned and controlled the property; in *Safe Deposit*, there was no jurisdiction because the person with forum contacts did not own or control the property.

Greenough and *Safe Deposit* are in harmony with one another and with *Brooke* and *Guaranty Trust*. Together, they establish an analytical construct consistent with first principles of fairness. A State may tax a resident beneficiary on income that she actually receives or controls (*Guaranty Trust*), and a State may tax a resident trustee on trust income that he owns and controls (*Greenough*). But a State may not tax a resident beneficiary on out-of-state trust income that she neither actually receives nor controls (*Brooke*), and, absent some other jurisdictional basis, a State may not tax a nonresident trustee for trust income that a resident beneficiary neither actually receives nor controls (*Safe Deposit*).

This framework, and particularly the holding of *Safe Deposit*, compelled the conclusion of every court to consider this case. Here, as in *Safe Deposit*, the State sought to tax the trust based solely on the residence of a beneficiary. As in *Safe Deposit*, the State relied on the beneficiary's forum contacts by arguing that the resident beneficiary "really own[s]" the trust property. *Safe Deposit*, 280 U.S. at 91. Here, as there, that argument "plainly conflicts with fact"; neither the beneficiary nor anyone else "within [the taxing State] ha[d] present right to [the funds'] control or possession" or "present right to their enjoyment." *Id.* at 91–92. Thus, as in *Safe Deposit*, the North Carolina tax is "unjust and oppressive," an effort to confiscate property over which the State has no constitutional jurisdiction. *Id.* at 93; *see Miller Bros. Co. v. Maryland*, 347 U.S. 340, 342 (1954) ("[S]eizure of property by the State under pretext of taxation when there is no jurisdiction or power to tax is simple confiscation and a denial of due process of law.").

B. *Hanson v. Denckla* Confirms the *Safe Deposit* Result and Resolves this Case

The outcome in *Safe Deposit* is confirmed by *Hanson v. Denckla*, 357 U.S. 235 (1958). The issue in that canonical due process case was whether a State could exercise jurisdiction over a nonresident trustee based on, among other things, the fact that the trust beneficiaries resided there. The Court held that the beneficiaries' residence in the State did not supply the minimum contacts necessary to sustain jurisdiction over the trustee.

1. *Hanson* rejected jurisdiction over a trustee based on the residence of a beneficiary

Hanson concerned a trust agreement executed in Delaware between a Pennsylvania-domiciled settlor and a Delaware trustee. The trustee was to provide income for life to the settlor as a beneficiary, with the remainder to be paid to other beneficiaries that the settlor designated. The settlor later moved to Florida, where she executed a power of appointment naming certain beneficiaries.

After the settlor's death, two of her children sued in Florida state court challenging the validity of the appointment. The beneficiaries, who were Florida residents, appeared as defendants, but the nonresident Delaware trustee was not served and did not appear. The defendants moved to dismiss on the ground that jurisdiction over the Delaware trustee would violate the Due Process Clause. The Florida courts rejected that contention and held the appointment invalid.

This Court reversed on the ground that Florida lacked jurisdiction over the trustee. The Court began by noting that, "[a]s technological progress has increased the flow of commerce between States, the need for jurisdiction over nonresidents has undergone a similar increase." *Id.* at 250–51. Nevertheless, the Court cautioned, "it is a mistake to assume that this trend heralds the eventual demise of all restrictions" on constitutional jurisdiction, and, even under the "flexible standard of *International Shoe*," the Court concluded that the trustee was not within the State's power. *Id.* at 251.

Whether jurisdiction is proper, the Court explained, depends on the existence of "minimal

contacts" with the trustee "that are a prerequisite to [the State's] exercise of power." *Id.* (internal citations omitted). The Court "fail[ed] to find such contacts in the circumstances of this case": The trustee "has no office in Florida, and transacts no business there. None of the trust assets has ever been held or administered in Florida, and the record discloses no solicitation of business in that State." *Id.* In addition, the Court observed, the trust was created "without any connection with the forum State": "The agreement was executed in Delaware by a trust company incorporated in that State and a settlor domiciled in Pennsylvania. The first relationship Florida had to the agreement was years later when the settlor became domiciled there, and the trustee remitted the trust income to her in that State." *Id.* at 252.

Throughout the analysis, the Court trained its focus on the trustee's own actions and conduct, rejecting efforts to attribute to the trustee forum contacts of other parties to the trust relationship. Thus, the Court noted that while the settlor and life beneficiary "carried on several bits of trust administration" in Florida, "the record discloses no instance in which the *trustee* performed any acts in Florida" that would support jurisdiction. *Id.* (emphasis added).

The Court similarly rejected the contention that Florida acquired jurisdiction over the trustee because the settlor and life beneficiary exercised the power of appointment in that State. It was specifically in this context that the Court articulated what is now a hallmark principle of due process:

> The unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum State. The application of that rule will vary with the quality and nature of the defendant's activity, but it is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws. The settlor's execution in Florida of her power of appointment cannot remedy the absence of such an act in this case.

Id. at 253–54 (internal citation omitted).

Finally, the Court addressed directly the argument that jurisdiction over the Delaware trustee was proper "because the settlor and most of the appointees and beneficiaries were domiciled in Florida." *Id.* at 254; *see id.* at 258 (Black, J., dissenting) (contending that Florida had power over the trustee because "the primary beneficiaries also lived in that State"). Basing jurisdiction on the presence of a beneficiary, the Court concluded, "is a nonsequitur." *Id.* at 254. While that fact could empower Florida to adjudicate the rights of the resident parties, it did not create jurisdiction over a different, nonresident entity. The issue, the Court explained, is jurisdiction, "not choice of law," and the jurisdictional question "is resolved . . . by considering the acts of the trustee," not those of other parties. *Id.* at 253–54.

Like *Safe Deposit*, *Hanson* resolves this case. In *Hanson*, as here, the issue was the validity of jurisdiction over a trustee as owner of the trust property in dispute. Like the State in this case, the *Hanson* petitioners and the dissenting opinion argued that the fact of in-state beneficiaries supported jurisdiction. The Court's response to that argument—that jurisdiction must be based on "the acts of the trustee," not the "unilateral activity" of a different person in the trust relationship, *id.* at 253—is dispositive here.

2. *Hanson* is materially indistinguishable

The State attempts to distinguish *Hanson* on two grounds, neither of which has merit.

First, the State contends that *Hanson* does not apply because it addressed jurisdiction to adjudicate, rather than jurisdiction to tax. The same principles govern in both contexts. *International Shoe* itself addressed jurisdiction both to tax and to adjudicate, reasoning that the "activities which establish[ed] [the corporation's] 'presence' subject it alike to taxation by the state and to suit to recover the tax." 326 U.S. at 321; *see id.* (concluding that minimum contacts gave the State "constitutional power to lay the tax and to subject appellant to a suit to recover it"). The very decision that the State describes as establishing the controlling test, *Quill Corp. v. North Dakota*, resolved the tax dispute there by relying on adjudicative jurisdiction cases. 504 U.S. at 307–08 (discussing *International Shoe*, *Shaffer v. Heitner*, and *Burger King*). The *Quill* Court "framed the relevant inquiry as whether" the taxpayer "had minimum contacts with the jurisdiction 'such that the [tax] does not offend traditional notions of fair

play and substantial justice.'" *Id.* at 307 (quoting *Int'l Shoe Co.*, 326 U.S. at 316).

The *Quill* Court's reliance on adjudicative jurisdiction cases was correct. "Jurisdiction is as necessary to valid legislative as to valid judicial action." *St. Louis v. Ferry Co.*, 78 U.S. (11 Wall.) 423, 430 (1870). The Due Process Clause "protect[s] a person against having the Government impose burdens upon him except in accordance with the valid laws of the land," *Giaccio v. Pennsylvania*, 382 U.S. 399, 403 (1966), and that principle "is no less true with respect to the power of a sovereign to resolve disputes through judicial process than with respect to the power of a sovereign to prescribe rules of conduct for those within its sphere." *J. McIntyre Machinery, Ltd. v. Nicastro*, 564 U.S. 873, 879 (2011) (plurality opinion). In both contexts, the minimum-contacts requirement ensures "fair warning that [a person's] activity may subject [him] to the jurisdiction of a foreign sovereign." *Quill*, 504 U.S. at 312 (citing *Shaffer*, 433 U.S. at 218 (Stevens, J., concurring)).

Thus, the "minimum connection" necessary for a State directly to demand money from a person under threat of criminal penalty does not meaningfully differ from the "minimum contacts" necessary for the State to require the person to defend against that demand. Indeed, this Court has used the formulations interchangeably. *E.g, South Dakota v. Wayfair Inc.*, 138 S. Ct. 2080, 2091 (2018) (describing an earlier tax decision as holding that the taxpayer "lacked the requisite minimum contacts with the State required by the . . . Due Process Clause"). And this Court has routinely applied minimum-contacts concepts when addressing state power to tax. *E.g.*,

Polar Tankers, Inc. v. City of Valdez, 557 U.S. 1, 11 (2009) ("[A] nondomiciliary jurisdiction may constitutionally tax property . . . when the taxpayer avails itself of the substantial privilege of carrying on business in that jurisdiction.") (internal citation and quotation marks omitted).[5]

Second, Petitioner incorrectly contends that *Hanson* does not apply because it concerned jurisdiction over the trustee, rather than over the trust. Pet. Br. 24. This Court long ago dismissed as an "ancient form without substantial modern justification" the "fiction that assertion of jurisdiction over property is anything but an assertion of jurisdiction over the owner of the property." *Shaffer*, 433 U.S. at 212. In both this case and *Hanson*, the person over whom the State asserted jurisdiction is the trustee. That was so in *Hanson* because the trustee owned the assets in dispute. It is so here because the trustee owns the income the State seeks to tax.

That the trustee is the relevant party for jurisdictional purposes is also a consequence of the State's own law. North Carolina imposes an income tax on individuals and then separately, in the statute at issue, requires the trustee to pay tax on trust income. N.C. Gen. Stat. § 105-160.2 (2017) ("The fiduciary responsible for administering the estate or trust shall pay the tax computed under the provi-

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[5] The State itself relies on adjudicative jurisdiction cases when it deems them helpful. Pet. Br. 45 (invoking the "modern analysis under the Due Process Clause" and citing *International Shoe*), 26 n.11 (relying on *Burger King*), 28 (relying on adjudicative jurisdiction cases to urge rejection of *Safe Deposit*).

sions of this Part."); N.C. Dep't of Rev., Form D-407A (2018) (directing that "the fiduciary must file" the return reflecting trust income).

In reality and under the law, there is thus no difference between asserting jurisdiction over the trustee as legal owner of the trust property and asserting jurisdiction over the "trust abstraction."[6] Relying on such a distinction represents the height of the "kind of formalism" that the State purports to disavow. Pet. Br. 25.

Hanson therefore controls here. That decision is a pillar of modern due process jurisprudence, its reasoning often recited and its result consistently reaffirmed.[7] Unless this Court repudiates both, North Carolina cannot prevail in this case.

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[6] Nor does the name of the party in the case caption make any difference. "[L]egal proceedings involving such traditional trusts are effectively brought by or against their trustees[.]" *Raymond Loubier Irrevocable Tr. v. Loubier*, 858 F.3d 719, 722 (2d Cir. 2017); *see also Americold Realty Tr. v. Conagra Foods, Inc.*, 136 S Ct. 1012, 1016 (2016) ("Traditionally . . . legal proceedings involving a trust were brought by or against the trustees in their own name[,]" and the trustee is also the relevant party "if the trust, as an entity, [is] sued.").

[7] Since deciding *Hanson*, this Court has invoked it as a key authority in nearly every subsequent due process decision. *See, e.g.*, *Bristol-Myers Squibb Co. v. Superior Ct.*, 137 S. Ct. 1773, 1780 (2017); *Walden*, 571 U.S. at 284–85, 288; *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 564 U.S. 915, 924 (2011); *Nicastro*, 564 U.S. at 877, 880–82; *Asahi Metal Industry Co., Ltd. v. Superior Ct.*, 480 U.S. 102, 109–10 (1987); *Burger King*, 471 U.S. at 474; *Ins. Corp. of Ir., Ltd. v. Compagnie des Bauxites de Guinee*, 456 U.S. 694, 713–14 (1982); *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 294–98 (1980); *(continued)*

II. DUE PROCESS PRINCIPLES COMPEL THE DECISION BELOW AND REFUTE THE STATE'S JURISDICTIONAL THEORIES

The holdings of *Safe Deposit* and *Hanson* align with the core set of principles this Court has prescribed for evaluating the outer constitutional limits of state jurisdiction. The State agrees that the outcome here should turn on "'the traditional notions of fair play and substantial justice' that shape modern analysis under the Due Process Clause." Pet. Br. 45 (quoting *International Shoe*). But aside from invoking "[f]reeform notions of fundamental fairness divorced from traditional practice," *Nicastro*, 564 U.S. at 880, the State does not attempt—and even urges this Court to avoid—application of the concrete principles that define the modern due process framework. Pet. Br. 21 n.9. Those tenets defeat the State's jurisdictional theories.

A. The State Cannot Show the Minimum Connection or Rational Relationship Necessary to Assert Jurisdiction

For the State to satisfy the Due Process Clause, it must establish that there exist minimum contacts, a "minimum connection, between a state and the person, property or transaction it seeks to tax, and that the income attributed to the State for tax purposes [is] rationally related to [fiscal] values connected with the taxing State." *Quill*, 504 U.S. at

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Kulko v. Superior Ct., 436 U.S. 84, 92–101 (1978); *Shaffer*, 433 U.S. at 215–16.

306 (internal quotation marks and citations omitted).[8]

The North Carolina tax fails this standard. The State's attempt to assert jurisdiction over the trustee based on nothing more than the forum residence of a contingent beneficiary conflicts with settled law that directs the focus on the trustee's own conduct. And the State cannot tax the worldwide income of the trust on the mere speculation that a forum resident may someday receive it.

1. Jurisdiction depends on the contacts of the taxpayer with the State and cannot rest solely on the taxpayer's relationship with a forum resident

"The inquiry whether a forum State may assert . . . jurisdiction over a nonresident [taxpayer] focuses on the relationship" between the taxpayer and the State. *Walden*, 571 U.S. at 283–84 (quoting *Keeton v. Hustler Magazine, Inc.*, 465 U.S. 770, 775 (1984)) (internal quotation marks omitted). The State cannot establish jurisdiction by pointing to the forum contacts of other parties; "[r]ather, it is the [taxpayer's own] conduct that must form the necessary connection with the forum State that is the basis for its jurisdiction over him." *Id.* at 285.

The necessary relationship "must arise out of contacts that the [nonresident] *himself* creates with

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[8] The State mischaracterizes the constitutional test. It asserts that "the Trust has the burden of establishing two elements": that the State "lacks a minimum connection," and that the amount taxed is "not rationally related" to the taxing State. Pet. Br. 15. As the party asserting jurisdiction, the State must satisfy both parts of the *Quill* standard.

the forum State." *Id.* at 284 (citing *Burger King*, 471 U.S. at 475) (internal quotation marks omitted). On that basis, this Court has "consistently rejected attempts to satisfy the . . . minimum contacts inquiry by demonstrating contacts between [third parties] and the forum State." *Id.* at 284. The "unilateral activity of another party or a third person is not an appropriate consideration when determining whether a [nonresident] has sufficient contacts with a forum State to justify an assertion of jurisdiction." *Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 417 (1984).

Nor can jurisdiction be based solely on "the [taxpayer's] contacts with persons who reside" in the forum State. *Walden*, 571 U.S. at 285. The taxpayer's "relationship with a . . . third party, standing alone, is an insufficient basis for jurisdiction." *Bristol-Myers*, 137 S. Ct. at 1781 (quoting *Walden*, 571 U.S. at 286).

The irreducible due process requirement remains the one *Hanson* established in the trust context: "[I]t is essential in each case that there be some act by which the [taxpayer] purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." 357 U.S. at 253; *see Goodyear*, 564 U.S. at 924; *Burger King*, 471 U.S. at 474 ("[T]he constitutional touchstone remains whether the [individual] purposefully established 'minimum contacts' in the forum State.").

2. There are no minimum contacts between the trustee and North Carolina

These enduring principles control this case. The State sought to tax the trustee on income of trust

property he owns and controls. It designated him as the person required to pay the tax. *See supra* p. 9. The jurisdictional inquiry therefore focuses on whether the trustee *himself* has minimum contacts with North Carolina.

The trustee has no such minimum contacts here. He did not engage in any conduct "purposefully avail[ing] [him]self of the privilege of conducting activities within the forum state." *Hanson*, 357 U.S. at 253. The State does not even attempt to argue otherwise. Instead, the State cites a single fact as grounds for jurisdiction: that a contingent beneficiary happened to move to North Carolina. Pet. Rep. in Supp. of Cert. 6–7 (asserting that this case presents only the question whether jurisdiction is proper based "solely on the presence of an in-state beneficiary").

Under this Court's decisions, the question presented thus answers itself. "If the question is whether an individual's [relationship] with an out-of-state party *alone* can automatically establish sufficient minimum contacts in the other party's home forum, we believe the answer clearly is that it cannot." *Burger King*, 471 U.S. at 478. A different person "cannot be the only link between the [taxpayer] and the forum." *Walden*, 571 U.S. at 285.

"In short, when viewed through the proper lens—whether the [taxpayer's] actions connect him to the forum—[the trustee] formed no jurisdictionally relevant contacts with" North Carolina. *Walden*, 571 U.S. at 289. Because the trustee lacks "the 'minimal contacts' with that State that are a prerequisite to its exercise of power over him," *Hanson*, 357 U.S. at 251, North Carolina's "unacceptably grasping" attempt at

jurisdiction violates the Due Process Clause. *Daimler AG v. Bauman*, 571 U.S. 117, 138 (2014).

3. There is no rational relationship between the taxed income and North Carolina's fiscal values

The North Carolina tax also fails the *Quill* requirement that the "income attributed to the State for tax purposes" must be "rationally related to [fiscal] values connected with the taxing State." 504 U.S. at 306.

The State taxed the worldwide income of the trust property through the trustee. None of that income was earned in the State, and no one in North Carolina received or enjoyed it during the relevant tax years. The State did not give the trustee "anything for which it could ask return," nor did the taxed income "bear[] fiscal relation to protection, opportunities, and benefits given by the state." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). The sole basis for the State's attribution of every penny of income to North Carolina was the possibility that the contingent beneficiary might someday receive it in North Carolina. That speculative basis does not satisfy *Quill* or due process.

B. The Contacts of Any "Trust Constituent" Are Not Attributable to Everyone Else in the Trust Relationship

The State's principal theory for jurisdiction is that the forum contacts of a beneficiary are attributable to the trustee. According to the State, the contacts of any person in the trust relationship are effectively the contacts of "the trust," and those contacts therefore bind the other "trust constituents" for

jurisdictional purposes. Thus, in the State's view, any State that has contacts with any "trust constituent" may assert jurisdiction over all other people associated with the trust.

That contention is incorrect. It conflicts with basic features of trust law and the actual relationship between trustee and beneficiary, it conflicts with the way in which this Court has approached questions of jurisdiction in the trust context, and it conflicts with North Carolina's own law.

1. The beneficiary and trustee are not agents, and the beneficiary does not represent the trust property

The State's argument misconceives the distinct roles that trustees and beneficiaries occupy in a traditional trust. Those distinct roles preclude the State's effort to treat the beneficiary and trustee as one for jurisdictional purposes on the ground that both are "trust constituents."

The trustee, not the beneficiary, represents the trust property and bears its rights and obligations. He can bind the trust property and is liable for all obligations incurred during the administration of the trust, including third-party claims against the trust assets. Austin W. Scott, William F. Fratcher & Mark L. Ascher, Scott & Ascher on Trusts ("Scott & Ascher on Trusts") §§ 26.1, 26.4 (5th ed. 2007); *Greenough*, 331 U.S. at 494 n.19 ("As a trustee holds the estate . . . he is personally bound by the contracts he makes as trustee, even when designating himself as such."). For procedural purposes, the trustee's domicile is dispositive, *see Americold*, 136 S Ct. at 1016, and "legal proceedings involving such tradi-

tional trusts are effectively brought by or against their trustees[.]" *Loubier*, 858 F.3d at 722.

Consistent with this principle, the trustee is liable for taxes assessed on the trust and for failure to file returns or pay taxes. Unif. Tr. Code § 816 (2000); George Gleason Bogert et al., *The Law of Trusts and Trustees* § 265 (2018) ("The liability of the Trustee for failure to file a tax return or to make estimated tax payments is the same as that of an individual.")

But this relationship between the trustee and the trust property does not apply to beneficiaries. The trustee does not represent the beneficiary: the trustee is not the beneficiary's agent and has no power to subject the beneficiary to third party claims. Scott & Ascher on Trusts §27.1; *see also* Restatement (Third) of Trusts § 103 (Am. Law Inst. 2003). This is true even when the trustee enters into a contract in the proper performance of his duties and purports to bind the beneficiaries personally. Scott & Ascher on Trusts §27.1 (The trustee "has no authority to act on behalf of the beneficiaries personally and is not subject to their control.")

Similarly, the beneficiary cannot bind trust property that does not legally belong to her. Where, as here, the trust instrument conveys to the trustee absolute discretion over the disposition of the trust property, a transferee or creditor of a beneficiary cannot compel the trustee to make distributions. Restatement (Third) of Trusts § 60 (Am. Law Inst. 2003). The beneficiary's inability to bind the trustee is reinforced by the inclusion of a spendthrift provision like the one in the trust agreement here, prohibiting the beneficiary from assigning or otherwise attaching the trust assets. Art. 12, App.

70 (prohibiting "attachment, execution, garnishment, sequestration or other seizure under any legal, equitable or other process.")

As a result, the State's assertion that a beneficiary "is a trust's most important constituent" means nothing in this context. Pet. Br. 29. Each of the "trust constituents" serves a distinct role; the trust cannot exist until the settlor expresses his intent to create it, and the trust cannot operate without a trustee to administer it.[9] The relevant question, however, is not the "importance" of the "constituent," but instead whether the practical nature of the relationships justifies the State's assertion of power over one person based on the actions of another. Under basic principles of trust law, the beneficiary's role does not support attribution of her actions to the trustee.

2. This Court's decisions in the trust context focus on the contacts of the person over whom the State asserts jurisdiction

This Court does not amalgamate the contacts of all "trust constituents" when evaluating jurisdiction over a person who is part of a trust relationship. Instead, as discussed above, *supra* § II(A), this Court

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[9] The beneficiary need not be ascertainable, or indeed in existence, at the time the trust is created. N.C. Gen. Stat. § 36C-4-409(1) (trust "without a definite or definitely ascertainable beneficiary" is valid); Scott & Ascher on Trusts §12.1. "Thus, for example, a trust can be created for the benefit of a child not born or conceived at the time of the creation of the trust, or for the benefit of a definite class of persons although the identity of the individuals comprising its membership is not ascertained or ascertainable at the time of the trust's creation." Restatement (Third) of Trusts, § 2 (Am. Law Inst. 2003).

has consistently focused on the particular person over whom the State seeks jurisdiction and decided whether that person's conduct gives rise to the necessary minimum connection. That is as true in the trust context as it is in due process jurisprudence generally.

Hanson exemplifies the proper analysis. There, the Court focused on the nonresident trustee and concluded that the trustee's own contacts did not support jurisdiction. The Court rejected an effort to attribute to the trustee the conduct of other parties in the trust relationship, emphasizing that "[t]he unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum State." 357 U.S. at 253. The State's basic theory in this case—treating the "trust constituents" as if they were interchangeable agents of a single trust entity—is the opposite of *Hanson*'s reasoning.

The State incorrectly invokes two cases to support its theory. First, the State contends that *Greenough* "treated a trust and its constituents as inextricably intertwined," Pet. Br. 26, such that "a trust constituent's residency in a state connects the trust to the state." *Id.* at 30.

That is a misreading of *Greenough*. The issue in *Greenough* was not whether jurisdiction was proper because *any* "trust constituent" resided in the State. Rather, the question was whether jurisdiction was proper specifically because the resident was a *trustee*. The Court upheld jurisdiction because of the unique features of the trustee's role as "the owner of the intangibles." 331 U.S. at 493; *see id.* ("This close relationship between the intangibles and the *owner*

furnishes an adequate basis for the tax *on the owner* by the state of his residence . . . . The state of the *owner's* residence supplies the *owner* with the benefits and protection inherent in the existence of an organized government.") (emphases added).

Because the beneficiary is not the owner of the trust property, the reasoning of *Greenough* does not "appl[y] equally to this case." Pet. Br. 30. As discussed above, *supra* pp. 21–22, the Court in *Greenough* distinguished *Safe Deposit* on exactly that basis. *Greenough*, 331 U.S. at 496 (noting that *Safe Deposit* "held invalid a state's tax on a trust's intangibles" because the property was "actually in the hands of the nonresident trustee and not subject to the control" of the resident beneficiary).

Second, the State contends that *Stone v. White*, 301 U.S. 532 (1937), rejected the "separateness theory" under which the contacts of people in the trust relationship are evaluated individually. *Stone* did not involve jurisdiction and did not change this Court's understanding of trust law. That case addressed a trust that gave the beneficiary an absolute right to the income "at such times and in such amounts as she should deem best." *Id.* at 533. In that context, the Court upheld imposition on the trustees of a tax that the beneficiary should have paid because it was on income that had been distributed to her. Given the beneficiary's actual ownership of the trust income and absolute right to demand it, the Court reasoned that it need not "shut its eyes to the fact that in the realm of reality it was the beneficiary's money which paid the tax." *Id.* at

535. Nothing in *Stone* affects the jurisdictional principles relevant here.[10]

3. North Carolina law treats beneficiary and trustee as separate and distinct entities

Not only are trustees and beneficiaries treated as separate and distinct under settled trust law and this Court's precedents, but they are also treated as independent actors by North Carolina itself.

Consistent with trust law generally, North Carolina statutes carefully assign the trustee and beneficiary distinct roles. In addition to authority conferred by the terms of the trust, the trustee possesses "[a]ll powers over the trust property that an unmarried competent owner has over individually owned property," as well as any "other powers appropriate to achieve the proper investment, management, administration or distribution of the trust property." N.C. Gen. Stat. § 36C-8-815 (2017). The trustee is empowered to "enforce claims of the trust and to defend claims against the trust." N.C. Gen. Stat. § 36C-8-811 (2018). North Carolina law further permits the trustee, among other things, to invest trust property, borrow money, abandon or

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[10] The State also incorrectly describes *Americold*, asserting that "[b]ecause of the abstract nature of a trust," the Court held that a trust's citizenship is determined by its membership. Pet. Br. 23 n.10. The entity in *Americold* "call[ed] itself a trust," but the Court concluded that the entity actually had "little in common with [a] traditional" trust. 136 S. Ct. at 1016. "For a traditional trust" like the one here, the Court confirmed, the trustee's "citizenship is all that matters for diversity purposes." *Id.*; *see also Navarro Sav. Ass'n v. Lee*, 446 U.S. 458, 462 (1980) ("[T]rustees are real parties in interest for procedural purposes").

relinquish rights, change the character of the trust property, and, with respect to securities, "exercise the rights of an absolute owner." N.C. Gen. Stat. § 36C-8-816 (2018).

The beneficiary has no comparable rights or powers. In fact, the trustee need not even "inform[] any beneficiary in advance of transactions relating to trust property." N.C. Gen. Stat. § 36C-8-813(b)(1) (2018). The beneficiary of a discretionary trust like the one here cannot encumber or transfer her interest in the trust, and a "creditor or assignee of a beneficiary may not reach a discretionary trust interest or a distribution by the trustee before its receipt by the beneficiary." N.C. Gen. Stat. § 36C-5-504(b) (2018). The discretionary beneficiary's only concrete right is to sue for abuse of discretion in complying with a standard for distribution. N.C. Gen. Stat. § 36C-5-504(e) (2018).[11]

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[11] North Carolina follows the majority rule that its courts are the appropriate forum only for "a trust having its principal place of administration in this State." N.C. Gen. Stat. § 36C-2-202 (2018). *See also* Restatement (Second) of Conflict of Laws § 267 (Am. Law Inst. 1971); Scott & Ascher on Trusts, § 45.2.2.6. Indeed, North Carolina law specifically prohibits the State's courts from adjudicating disputes involving out-of-state trusts absent extraordinary circumstances. *See* N.C. Gen. Stat. § 36C-2-203(2) (2018) ("The clerk of court shall not, over the objection of a party, entertain proceedings under this section involving a trust having its principal place of administration in another state except" when, among other things, "the interest of justice otherwise would be seriously impaired."). Thus, unlike in *Greenough*, the tax cannot be justified by the benefit the State provides the trustee in the form of access to its courts. North Carolina courts would be presumptively closed to disputes between the trustee and fiduciary over this trust. *Cf. Greenough*, 331 U.S. at 495 ("There may be matters of trust

(continued)

The State's tax system reinforces that separation between beneficiary and trustee. North Carolina law imposes a tax on beneficiaries as individual taxpayers for the income actually distributed to them. It separately imposes on trustees a tax for the income of the trust property they represent. N.C. Gen. Stat. § 105-160.2 (2017) ("The fiduciary responsible for administering the estate or trust shall pay the tax" on trust income); *see Sabine v. Gill*, 51 S.E.2d 1, 4–5 (N.C. 1948) (concluding that, as a result of North Carolina tax statutes, "the distance here between the trustees and the beneficiary seems to be too great for the judiciary to close the gap by making them to all intents and purposes one," and that "[t]he trusteeship is far from a mere agency which might lend itself to the concept of constructive holding" for the beneficiary).

What the State calls the "separateness theory" is, therefore, the result of its own laws.[12]

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administration which can be litigated only in the courts of the state that is the seat of the trust.").

[12] North Carolina's statutes reflect "the tendency of modern law to treat trusts as distinct legal entities" akin to corporations. Restatement (Third) of Trusts § 2 (Am. Law. Inst. 2003), comment i; *see id.* at comment a (describing as "outmoded" the "concept that a trust is not an entity"); N.C. Gen. Stat. § 36C-1-103(12) (2018) (defining "person" to include a trust); N.C. Gen. Stat. § 58-1-5(9) (2018) (defining a trust as a "person" for insurance purposes).

This Court could thus affirm on the alternative ground that the State, having decided to treat trusts as corporate-like entities that are separate and distinct from trust beneficiaries, cannot then deny that separate status for jurisdictional purposes by arguing that the trust and its beneficiaries are effectively one and the same.

C. The State Cannot Assert Jurisdiction over the Trustee on the Basis of Public Services Provided to a Beneficiary

The State next contends that it may tax the trustee in exchange for the public services it provided to the resident beneficiary. Pet. Br. 30–36. That argument fails for three basic reasons.

First, it suffers from the same flaw as the State's principal theory, "improperly attribut[ing] [another person's] forum connections to the [taxpayer] and mak[ing] those connections decisive in the jurisdictional analysis." *Walden*, 571 U.S. at 289 (internal citation and quotation marks omitted). The State focuses on benefits provided to the beneficiary, but the State taxed the trustee, so the relevant question is what benefits the *trustee* received. The State posits indirect ways in which North Carolina helped the trustee because of his relationship with the beneficiary. But "financial benefits accruing . . . from a collateral relationship to the forum State will not support jurisdiction if they do not stem from a constitutionally cognizable contact with the State." *World-Wide Volkswagen*, 444 U.S. at 299. On that basis, the Court rejected in *Kulko* exactly the argument the State is now advancing. There, the Court addressed the contention that California's jurisdiction over a Florida parent was proper because of public benefits California had provided his minor child:

> The court below stated that the presence in California of appellant's daughter gave appellant the benefit of California's police and fire protection, its school system, its hospital services, its

> recreational facilities, its libraries and museums . . . . But, in the circumstances presented here, these services provided by the State were essentially benefits to the child, not the father, and in any event were not benefits that appellant purposefully sought for himself.

436 U.S. at 94 n.7 (internal quotation marks omitted). That reasoning is even more compelling in this case. *Kulko* involved a parent with mandatory support obligations to the resident, whereas the trustee here had no legal obligation to provide anything to the beneficiary during the relevant period. And in *Kulko*, the parent sent the resident to the forum State to live. The trustee here, in contrast, had no control over the beneficiary's choice of residence.

Second, the State's public-benefits argument rests on premises that are incorrect, factually and legally. The State claims unfairness in the beneficiary consuming state resources without paying for them. But the beneficiary did pay North Carolina tax on all income that she and her family had actually received in exchange for the "benefits and protections that come with residency in North Carolina." Pet. Br. 34. The beneficiary had not received, had no right to receive, and did not own or control any of the income on trust property during the tax years. Whether to distribute that income was left to "the Trustee's absolute discretion." Art. 1 § 1.1(a), App. 46. Indeed, the beneficiary may not ever have received any trust assets. *See supra* pp. 3–5. There is thus no basis for treating the income as if it were hers. *Cf. Sabine*, 51 S.E.2d at 5 (rejecting beneficiary's claimed deduction

for taxes paid by the trustee because, under North Carolina statutes, the property belonged to the trustee "and [became] hers only by distribution").

The State also misstates the record in arguing that the protections North Carolina provided the beneficiary "replaced services that the Trust otherwise would have had to buy" for her. Pet. Br. 34–35. In fact, the trustee was not required to provide any income or principal to the beneficiary during the years at issue. While the trust agreement highlighted certain life events as guidance to the trustee, Art. 1 § 1.4(c), App. 51, the decision whether to distribute income and principal remained the trustee's alone. *Id.* at 46–47. That decision could be challenged only if it were "arbitrary or the result of bad faith." *Supra* p. 5.

Third, there are no discernable limits to the theory that a State may premise jurisdiction over a trustee on public services to a beneficiary. That theory would not be limited to the beneficiary's residence. It would also permit taxation by any State that, because the beneficiary spent a meaningful amount of time there, could claim to have "give[n] the beneficiary the interim protection of its laws" and provided her valuable services. Pet. Br. 33 (internal quotation marks omitted); *cf. Walden*, 571 U.S. at 290 (rejecting respondent's theory as overbroad because it would support jurisdiction not only in the forum State but also "wherever else [a third party] might have traveled").

Nor would the State's theory be confined to the trust context. According to that theory, when a State provides benefits and protections to a person while property she may someday receive generates income

elsewhere, "it is only fair" to permit the State to "demand a return" by taxing the current property owner for that income. Pet. Br. 17. This reasoning would apply to a parent who resides in New York and executes a will that contemplates the eventual distribution of all his assets to his only child, who resides in North Carolina. The State could equally contend in those circumstances that "North Carolina offered [the child] wide-ranging protections and services" while "income accumulated for [her] benefit," Pet. Br. 17, and on that basis impose a tax directly on the New York parent's income. Even the State would presumably not endorse that unfair result.

D. A Fiduciary Relationship with a Forum Resident Does Not Constitute Purposeful Availment by the Trustee

The State argues that the fiduciary nature of the trust relationship necessarily creates constitutional jurisdiction over the trustee wherever a beneficiary decides to live. Pet. Br. 26 & n.11. This Court has twice rejected that contention, and this case demonstrates why it should do so again.

In *Shaffer v. Heitner*, the Court considered whether Delaware could exercise jurisdiction over nonresident corporate officers of a Delaware corporation. Both the dissent and the appellee contended that the officers' decision to accept their positions and thereby to assume fiduciary obligations to a Delaware resident provided sufficient "contacts, ties, or relations" with that State to support jurisdiction. *Id.* at 213–14 (internal quotation marks omitted). The dissent argued that the officers "voluntarily associated themselves with the State[,]

. . . invoking the benefits and protection of its laws, by entering into a long-term and fragile relationship with one of its" residents. *Id.* at 227–28 (Brennan, J., dissenting) (internal citation and quotation marks omitted). The Court disagreed, holding that the acceptance of fiduciary obligations to a forum resident does not constitute "purposeful[] avail[ment] of the privilege of conducting activities within the forum State." *Id.* at 216 (internal citation and quotation marks omitted).

Hanson, of course, stands for the same proposition in the trust context. The Court refused to uphold jurisdiction over a nonresident trustee despite the trustee's fiduciary obligations to the resident beneficiaries. There, too, the Court rejected the argument that jurisdiction was proper because the trustee had availed itself of the forum by "maintain[ing] business relations" with the settlor and beneficiary, *id.* at 259 (Black, J., dissenting), or because the "community of interest" between the trust constituents was "so close" as to deem them "in privity," *id.* at 263 (Douglas, J., dissenting).

The State attempts to analogize this case to *Burger King*, but that comparison is inapt. Pet. Br. 26 & n.11. The Court upheld jurisdiction there because the franchisee had "deliberately reached out . . . and negotiated with a Florida corporation," entered into a commercial contract governed by Florida law, and accepted the "exacting regulation" of his business by the Florida corporation. 471 U.S. at 479–80 (internal quotation marks omitted).

No such circumstances are present here. The trustee did not reach into North Carolina to initiate a relationship, he has no contractual relationship

with the beneficiary, the trust is not governed by North Carolina law, the trustee is not subject to control or regulation by any North Carolina party, and he owed the North Carolina beneficiary nothing other than the good-faith exercise of his absolute discretion. The beneficiary's decision to reside in North Carolina "was completely adventitious as far as [the trustee] was concerned." *Rush v. Savchuk*, 444 U.S. 320, 328–29 (1980). "He had no control over that decision," and he did not by accepting the settlor's appointment subject himself to jurisdiction "in any state to which a potential [beneficiary] might decide to move." *Id.* at 329.

This case illustrates the error in the State's argument. For the first 15 years of the trust's existence, the beneficiary did not know the trust existed, and she never met the initial trustee. *See supra* p. 7. Even after the beneficiary eventually learned of the trust, she interacted "very infrequently" with the trustee and met with him only twice, both times in New York. App. 106–07, 126. That is not the kind of relationship that, by its nature, is necessarily so "intensive" and "inextricably intertwined" that jurisdiction over the trustee must follow the beneficiary. Pet. Br. 26 & n.11.

III. NORTH CAROLINA DOES NOT ACQUIRE JURISDICTION BECAUSE IT DISAGREES WITH THE TAX POLICY OF OTHER STATES

The State attempts to justify its jurisdictional overreach by advancing a series of policy arguments centered on the concern that the decision below opened a "judicially created tax shelter." Those arguments are incorrect and vastly overstated; the States have ample means of taxing trust income.

The State's real complaint is not that States lack constitutional power to tax, but rather that some of the States that possess power to tax have chosen not to use it. That disagreement does not give North Carolina license to extend its jurisdiction beyond constitutional boundaries.

A. States Have Ample Means of Taxing Trust Income Undisturbed by the Decision Below

The premise of North Carolina's policy argument is that the decision below "lays waste to the states' taxing authority" because it deprives States of the ability to tax trust income. Pet. Br. 2. As the Brief for the American College of Trust and Estates Counsel ("ACTEC Br.") demonstrates, that is simply not the case. States tax trust income in many different ways that the decision below does not disrupt. *See* ACTEC Br. 12–19 (describing the numerous ways in which States tax trusts).

The various approaches the States have employed largely align with the same considerations of actual ownership, control, and receipt underlying this Court's decisions. Thus, States tax the income of a grantor trust—one where the settlor retains control or ownership of the property—to the resident settlor.[13] When the beneficiary actually receives distributions, the State of the beneficiary's residence

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[13] Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶ 20.09 (2019). For the federal rule, *see* 26 U.S.C.A. § 676 (a) (1986) ("The grantor shall be treated as the owner of any portion of a trust . . . where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a nonadverse party, or both.")

collects taxes.[14] States also tax trust income to the extent it is sourced to property or activity occurring within that State.[15]

This case concerns accumulated trust income that the trustee does not distribute in a particular year. States may and do tax such income in several ways. North Carolina incorrectly asserts that the decision below means that "the only state that can tax trust income is the state where a trustee lives." Pet. Br. 17. To be sure, a State with a resident trustee may tax undistributed income each year it is generated.[16] So, too, may a State in which a trust is administered.[17] But the State where the beneficiary resides may also collect taxes on accumulated income that was not distributed in a given year in one of two ways. If the beneficiary has an absolute right to the income, the beneficiary's State of residence may tax her for it regardless whether the income was distributed.[18] If, as here, the beneficiary's interest is instead contingent, the State of the beneficiary's residence may, pursuant to a "throwback" tax regime, collect tax on accumulated income from

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[14] *See Lawrence*, 286 U.S. at 280–81 (noting the established principle that the State of residence may tax an individual on all actual income from whatever source derived).

[15] *See, e.g.*, Me. Stat. tit. 36, §§ 5163, 5175-A (2017); Mich. Comp. Laws § 206.110 (2018); R.I. Gen. Laws §§ 44-30-16, 44-30-35 (2018); *see also* ACTEC Br. 5 n.12.

[16] *See, e.g.*, Ariz. Rev. Stat. Ann. §§ 43-1301(1)(b)(5) (2019); Ark. Code Ann. § 26-51-203 (2019); Cal. Rev. & Tax. Code § 17742 (2019).

[17] *See, e.g.*, Colo. Rev. Stat. § 39-22-103(10) (2018); S.C. Code Ann. § 12-6-30(5) (2018). *See also* ACTEC Br. 10–11.

[18] *See* 26 U.S.C.A. §§ 671, 678(a) (1954).

distributions made in future years. In States with such a throwback tax, income that was not taxed in the year it was generated is taxed to the resident beneficiary if and when she actually receives it—not, as with North Carolina's tax, to the nonresident trustee based on speculation that the resident beneficiary someday *might* receive it.[19] *See* ACTEC Br. 15–19 (explaining the operation of the "throwback" tax).

Thus, the ruling below rejected a single, specific tactic that only North Carolina and two other States have even attempted: taxing a trustee with which the State has no connection, on income that has not been distributed, solely on the possibility that at some later point the income might be distributed to a resident contingent beneficiary.[20] The North

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[19] *See, e.g.*, 61 Pa. Code § 105.5(c) (2019); Cal. Rev. & Tax Code § 17745(b) (2019); N.Y. Tax Law § 612(b)(40) (2019).

[20] Only Tennessee and Georgia also have statutes taxing nonresident trustees for undistributed income solely on the ground that a contingent beneficiary resides in the State. Tenn. Code § 67-2-110(a) (2018); Ga. Code Ann. § 48-7-22(a)(1)(C) (2017). Tennessee, however, has voted to eliminate the income tax entirely as of January 1, 2021. *See* H.R. 534, 110th Gen. Assemb., Reg. Sess. (Tenn. 2017) (enacted). Practitioners disagree about whether Georgia law actually requires such a tax on nonresident trustees. *See* ACTEC Br. 11 n.11 (citing Ga. Comp. R. & Regs. 560-7-8- 35(1)(d)).

California imposes such a tax only if the resident beneficiary actually receives, or has a noncontingent right to receive, the income in a particular year. Cal. Rev. & Tax Code § 17742(a) (2019); Franchise Tax Board, TAM 2006-2002, p. 2 ("A resident beneficiary whose interest in a trust is subject to the sole and absolute discretion of the trustee holds [only] a contingent interest in the trust."), *available at*

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Carolina courts correctly concluded that this method did not respect constitutional limits on jurisdiction.

B. Differences in Tax Policy Are a Consequence of Federalism and Do Not Expand North Carolina's Jurisdiction

The myriad approaches to trust taxation reflect the different choices of voters in the various States. North Carolina's disagreement with those choices does not permit it to assert jurisdiction over persons with whom it lacks the requisite minimum contacts.

There is no dispute that the income of this trust was within the taxing power of multiple States. Whether and how the income was actually taxed turned on the tax laws of the particular States with jurisdiction—laws that reflect those States' considered policy choices. In light of those choices, North Carolina and its State *amici* cannot attribute the results to the judiciary. Connecticut joins the State *amici* despite the fact that, as the State of the trustee's residence, it could have taxed the very income at issue in this case but chose not to. The State of Washington joins, expressing "grave concern" about the revenue impacts of the decision below, despite the fact that it imposes no income tax at all on anyone. Brief for Minnesota *et al.*, at 1.

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https://www.ftb.ca.gov/law/Technical_Advice_Memorandums/2006/20060002.pdf.

The remaining statutes that North Carolina cites (Pet. Br. 6 n.1) require further connections with the taxing State and therefore do not implicate the question presented here: whether a State may tax a nonresident trustee based solely on the fact of a resident contingent beneficiary.

North Carolina itself has decided not to tax trust income on the ground that a trustee or other fiduciary, as opposed to a beneficiary, resides in the State. Nor does North Carolina tax on the ground that the trust is administered there. That choice, which aligns with the State's concerted efforts to court a thriving banking industry,[21] is within the State's "sovereign right to formulate tax policy," *id.* at 9, reflecting a judgment to forgo certain tax revenue in favor of other objectives.

But differences among state tax laws, and concomitant respect for the limits of state power, do not create and have never been considered a "judicially created tax shelter." Instead, they are critical features of federalism. Observing the constitutional boundaries of state jurisdiction furthers the States' prerogative to make individualized choices without interference from other States that lack a legitimate interest. *See Bristol-Myers*, 137 S. Ct. at 1780–81 ("The sovereignty of each State . . . implie[s] a limitation on the sovereignty of all its sister States."). Indeed, one of the key functions of the minimum-contacts principle is to ensure that States "do not reach out beyond the limits imposed on them by their status as coequal sovereigns in a federal system." *World-Wide Volkswagen*, 444 U.S. at 292.

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[21] *See Key Industries in North Carolina – Business & Financial Services*, North Carolina Dep't of Commerce (touting the State's "low tax burdens" as a prime reason "financial institutions flock to North Carolina"; citing as a "competitive advantage" that "NC is ranked No. 1 for lowest state and local tax burden in the United States") (last visited March 14, 2019), https://www.nccommerce.com/business/key-industries-north-carolina/business-financial-services.

The decision below does not "end the states' ability to adopt tax approaches" to address the concerns that North Carolina perceives. Pet. Br. 42. The States can and frequently do reconsider the decisions they have made in this context.[22]

North Carolina's true complaint is thus not about the lack of state power to tax, but instead about the decision of certain States not to exercise that power. This Court has refused to base jurisdiction on these sorts of differences among laws in non-forum States. *E.g.*, *Keeton*, 465 U.S. at 779 ("Whether Ohio's limitations period is six months or six years does not alter the jurisdictional calculus in New Hampshire"; that other States would apply different rules "has nothing to do with the contacts" that matter for jurisdictional purposes). North Carolina's policy disagreements with other States are similarly irrelevant to its constitutional jurisdiction. *See Greenough*, 331 U.S. at 490 ("Neither the expediency of the levy nor its economic effect on the economy of the taxing state is for our consideration.").[23]

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[22] Tennessee, for example, voted in 2017 to eliminate the income tax. *See supra* n.20. In 2010, Washington voters considered but defeated a ballot initiative imposing an income tax. *See* Sec'y of State, State of Wash., Initiative Measure No. 1098 (filed Apr. 27, 2010), *available at* https://www.sos.wa.gov/elections/initiatives/text/i1098.pdf. In 2006, the Florida legislature repealed an intangible personal property tax. H.B. 209, 2006 Leg., Reg. Sess. (Fla. 2006) (enacted). In 2002, Ohio adopted an income tax on trustees. H.R. 675, 124th Gen. Assemb., Reg. Sess. (Ohio 2002) (enacted).

[23] Equally misplaced is the State's concern that the decision below will motivate behavior intended to minimize state tax burdens. Only North Carolina and two other States currently impose the tax at issue, so its invalidation will have little

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C. *Wayfair* Is Not Relevant

North Carolina repeatedly invokes *South Dakota v. Wayfair*, 138 S. Ct. 2080 (2018), but that case is not relevant here. *Wayfair*, a Commerce Clause decision, endorsed the minimum-contacts framework that both parties agree governs this case. *Wayfair* rejected a physical-presence rule that played no part in the decisions below because *Quill* long ago rejected that requirement in the due process context.

The Court overruled previous cases in *Wayfair* based on intervening "dramatic technological and social changes" reflected in e-commerce. *Id.* at 2095 (internal quotation marks omitted). Technological changes have not had the same impact on trust administration. At least since *Greenough*, this Court has recognized that trustees are not stationary or affixed to one State. 331 U.S. at 493 ("The trustee of today moves freely from state to state. The settlor's residence may be one state, the seat of a trust another state and the trustee or trustees may live in still another jurisdiction or may constantly change their residence."); *see Hanson*, 357 U.S. at 250–51

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practical effect. In any event, taxpayer decisions based on the differential impact among state laws are a consequence of federalism. That individuals routinely consider how they would fare under various State tax regimes has no relevance to North Carolina's jurisdiction, nor is it a "fairness" argument in the State's favor. "Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant." *Comm'r v. Newman*, 159 F.2d 848, 850–851 (2d Cir. 1947) (Learned Hand, J., dissenting).

(rejecting jurisdiction over the trustee even while recognizing that "technological progress has increased the flow of commerce between States").

To the extent *Wayfair* has any application, it confirms the decision below. In *Wayfair*, South Dakota argued that a nonresident taxpayer's own forum-directed conduct created a sufficient nexus for the State to collect sales tax from resident customers. Here, in contrast, North Carolina seeks to assert jurisdiction over one party based entirely on the forum contacts of someone else. Thus, if there is any analogy to be drawn to *Wayfair*, it demonstrates the error of North Carolina's position, which is the equivalent of contending that the respondent in *Wayfair* could be taxed by every State in which any one of its beneficial shareholders resided, based solely on the fact of their residence. That argument fails under the most basic principles of due process.

CONCLUSION

Respondent respectfully submits that the judgment of the court below should be affirmed.

Respectfully submitted,

DAVID A. O'NEIL
Counsel of Record
ANNA A. MOODY
LAURA E. O'NEILL
DEBEVOISE & PLIMPTON LLP
801 Pennsylvania Ave. N.W.
Washington, D.C.
(202) 383-8000
daoneil@debevoise.com

THOMAS DEAN MYRICK
MOORE & VAN ALLEN PLLC
100 North Tryon Street
Charlotte, N.C. 28202
704-331-1126
tommyrick@mvalaw.com

Counsel for Respondent

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NORTH CAROLINA
DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST,

Respondent.

On Writ Of Certiorari To The Supreme Court Of North Carolina

PETITIONER'S REPLY BRIEF

ROBERT F. ORR
ROBERT F. ORR, PLLC
3434 Edwards Mill Rd.
Suite 112-372
Raleigh, NC 27612
(919) 608-5335

ANDREW H. ERTESCHIK
SAAD GUL
JOHN M. DURNOVICH
NATHANIEL C. ZINKOW
POYNER SPRUILL LLP
Post Office Box 1801
Raleigh, NC 27602
(919) 783-2895

JOSHUA H. STEIN
Attorney General

MATTHEW W. SAWCHAK
Solicitor General
Counsel of Record
JAMES W. DOGGETT
Deputy Solicitor General
RYAN Y. PARK
Deputy Solicitor General
NORTH CAROLINA
DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400
msawchak@ncdoj.gov

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

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John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 Yale L.J. 165 (1997) 5, 7

Richard W. Nenno, *Bases of State Income Taxation of Nongrantor Trusts* 27

INTRODUCTION

Quill's minimum-connection analysis centers on fundamental fairness. *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992). As the Department's opening brief showed, this fairness-based analysis supports the tax at issue here.

Because a trust is just a relationship between multiple people, a trust has no jurisdictional contacts of its own. *Americold Realty Tr. v. Conagra Foods, Inc.*, 136 S. Ct. 1012, 1016 (2016). Instead, its contacts are those of the people in the trust relationship. *See Greenough v. Tax Assessors*, 331 U.S. 486, 495 (1947).

Of the people in the trust relationship, the beneficiary—the trust's central figure—has the most important jurisdictional contacts. Pet'r's Br. 29–33. After all, serving the beneficiary's interests is a trust's reason for being. *Id.* at 29–30. When a state provides benefits and protections to a trust beneficiary, the state benefits her trust. *Id.* at 30–36.

In light of this reality, the tax here is fundamentally fair: North Carolina has given the Kaestner Trust something for which the state can ask for taxes in return. *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 24–25 (2008) (applying this standard).

The Trust's response does not meaningfully rebut this analysis. Instead, the Trust repeatedly relies on two false premises to argue that trustees' contacts alone count for due-process purposes.

First, the Trust relies on the premise that a trustee is the true owner of trust income. That argument conflicts with core principles of trust law. Trust law makes beneficiaries, not trustees, the true owners of trust assets. Because of a beneficiary's ownership interest, her jurisdictional contacts count at least as much as a trustee's contacts do.

Second, the Trust relies on the premise that when North Carolina taxes trust income, the state is taxing the trustee, not the trust. This argument contradicts the arguments that the Trust made in its brief in opposition to certiorari.

In any event, the Trust's new argument is mistaken. The operative statute taxes trusts, not trustees. Further, taxes on trust income economically affect beneficiaries, not trustees.

Once these linchpins of the Trust's response are removed, little remains.

The Trust's doctrinal arguments misunderstand this Court's decisions on due process and trust taxation. The Trust relies on *Pennoyer*-era cases, as well as cases that did not involve taxes on a trust. The Trust is mistaken when it argues that "those precedents control here." Resp't's Br. 12.

Nor has the Trust explained away the massive tax shelter that its proposed rule would create. To the contrary, the Trust's brief heightens those concerns. The Trust proposes a rule that would invalidate statutes in a majority of the states.

Nothing in the Due Process Clause requires such a result. Under *Quill*'s fairness-based analysis, due process does not bar states from taxing a resident beneficiary's trust income.

ARGUMENT

I. The premises of the Trust's arguments are false.

A. A trustee is not the true owner of a beneficiary's trust income.

The Department's opening brief showed that, out of the people in the trust relationship, the beneficiary has the most important jurisdictional contacts. Pet'r's Br. 29–33. In response, the Trust tries to diminish the beneficiary's status. It claims that "there is no basis to treat [trust] income as if" it belongs to the beneficiary. Resp't's Br. 14; *see id.* at 40. The Trust goes on to argue that the trustee is the "owner of the trust property," so only his contacts should count. *Id.* at 27.

The Trust's argument contradicts modern due-process analysis, as well as fundamental principles of trust law.

In a due-process challenge to a tax, "this Court concerns itself with the practical operation of the tax, that is, substance rather than form." *Am. Oil Co. v. Neill*, 380 U.S. 451, 455 (1965) (citing *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 443–44 (1940)).

When a state taxes trust income, that tax does not burden a trustee economically. Instead, "only [the beneficiary] is ultimately burdened." *Stone v. White*, 301 U.S. 532, 538 (1937). In *Stone*, the Court recognized that "in the realm of reality it was the beneficiary's

money which paid the tax." *Id.* at 535. The Court declined to "shut its eyes to [that] fact." *Ibid.*[1]

The reality that *Stone* acknowledged is a bedrock principle of trust law: Beneficiaries—not trustees—are the true owners of their trust assets. John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 Yale L.J. 165, 181 (1997); *see, e.g.*, *People v. Mishkin*, 521 N.Y.S.2d 296, 296 (App. Div. 1987) (referring to beneficiaries as "the true owner[s]" of trust assets); *Tyndall v. Tyndall*, 119 S.E. 354, 356 (N.C. 1923) (referring to a beneficiary as "the real owner" of trust assets).

The facts here underscore this principle of trust law:

- As Ms. Kaestner herself testified, the Trust here existed for one purpose: "to give me money." App. 82.
- During all of the tax years at issue, Ms. Kaestner and her children were the only people eligible to receive distributions. App. 46–47 (art. 1.2(a)–(b)).

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[1] The Trust tries to distinguish *Stone* by noting that the beneficiary in that case had a right to income for life. Resp't's Br. 40–41. But nothing in *Stone* suggests that the Court's rationale turned on any feature of the trust instrument in that case. Indeed, the Court implied the opposite: It noted that "*whenever* the trustee brings suit" on behalf of a trust, that lawsuit "is for the benefit and in the equitable interest of the [beneficiary]." *Stone*, 301 U.S. at 536 (emphasis added).

- The trust instrument required that Ms. Kaestner personally receive all of the trust assets in 2009, when she turned 40. App. 47 (art. 1.2(c)(1)); App. 83. The only reason why Ms. Kaestner did not receive those assets in 2009 was that the trustee decanted the trust assets into another trust—an event that occurred only after the trustee consulted with Ms. Kaestner. App. 97; Pet'r's Br. 9–10.
- A few years after the decanting, Ms. Kaestner did receive trust assets. N.C. R. 214–15.[2]

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[2] Despite these facts, the Trust refers repeatedly to Ms. Kaestner as a "contingent" beneficiary, without ever defining that label or stating any reason why the label might matter for due-process purposes. *E.g.*, Resp't's Br. i (Question Presented). For at least three reasons, the label does not help the Trust.

First, what matters for due process is not how an interest is labeled, but whether a resident beneficiary is eligible to receive distributions at the time of the tax. *See infra* pp. 19–21, 23–25. Here, during all of the tax years at issue, the only beneficiaries eligible to receive distributions were Ms. Kaestner and her children, who were North Carolinians during these years. App. 46–47 (art. 1.2(a)–(b)).

Second, the Trust's label contradicts the Trust's own complaint. The complaint describes Ms. Kaestner and her children as the Trust's "current beneficiaries." App. 11. It contrasts them with the Trust's "contingent remainder beneficiaries," who live outside of North Carolina. App. 11.

Third, Ms. Kaestner's interest was not "contingent" in any meaningful sense. She was required to receive all the trust assets in June 2009, just six months after the tax years at issue. App. 47 (art. 1.2(c)(1)).

Trust law describes this type of interest in trust assets as a beneficiary's equitable interest. *Commonwealth v. Stewart*, 12 A.2d 444, 447 (Pa. 1940), *aff'd mem.*, 312 U.S. 649 (1941); *Blair v. Comm'r*, 300 U.S. 5, 14 (1937). Her equitable interest is "an *actual property interest* in the subject-matter of the trust." *Stewart*, 12 A.2d at 446–47 (emphasis added); *accord Blair*, 300 U.S. at 14; Trust Profs.' Br. 9–12.

The trustee's interest in trust assets, by contrast, is "merely nominal." Langbein, *supra*, at 181. The trustee has no interest in trust property "other than as the depositary of the legal title." *Robertson v. Bullions*, 11 N.Y. 243, 270 (1854); *Tyndall*, 119 S.E. at 356 (same).

Thus, in every meaningful sense, a beneficiary, not a trustee, is the true owner of the assets in a trust.

A hypothetical illustrates this point. Suppose that a trustee used some of the trust income to buy himself a car, then defended his action on the theory that he was the true owner of the trust assets. No court would accept that defense. *See, e.g.*, *Mishkin*, 521 N.Y.S.2d at 296 (rejecting trustee's "contention that he had a right of ownership equal to that of the . . . beneficiaries").

In sum, a key premise of the Trust's argument that only the trustee's contacts should count—the premise that the trustee is the real owner of trust property—is false.

B. North Carolina taxed the Trust, not the trustee.

The Trust's response also depends on a second false premise: that "[t]he State sought to tax the trustee," not the Trust. Resp't's Br. 33. Relying on that premise, the Trust argues that the Court should "focu[s] on whether the trustee *himself* has minimum contacts with North Carolina." *Id.* at 34.

That argument clashes with what the Trust argued in all of the North Carolina courts and in its brief in opposition to certiorari.

- For example, in the state supreme court, the Trust argued that "it is the entity the state seeks to tax—*here the Trust*—that must have the connection with the forum state." Resp't's N.C. S. Ct. Br. 27 (emphasis added).

- Likewise, at the petition stage in this Court, the Trust framed this case as one in which "the State sought to tax the . . . income of a trust." Resp't's Cert. Opp. i (Question Presented). It went on to argue that "[t]he Kaestner Trust has no connection to North Carolina." *Id.* at 8.

The Trust is now retreating from its insistence on trust-level contacts—and for good reason. As the Department has argued throughout this case, a trust is merely a fiduciary relationship between people, not "a distinct legal entity." *Americold*, 136 S. Ct. at

1016.[3] Therefore, a trust cannot make entity-level connections between "itself" and a state. Pet'r's Br. 16.

To try to save the state-court judgment on alternative grounds, the Trust now argues that "[t]he State sought to tax the trustee." Resp't's Br. 34. It goes on to argue that the real question here is "whether the trustee *himself* has minimum contacts with North Carolina." *Ibid.*[4]

That new argument fails for multiple reasons.

First, the argument was not preserved in—and, indeed, contradicts—the Trust's brief in opposition to certiorari. Under these circumstances, this Court "typically will not address a question . . . even if the answer would afford an alternative ground for affirmance." *MeadWestvaco*, 553 U.S. at 31; *see* S. Ct. R. 15.2.

Second, the Trust's new argument fails on the merits. North Carolina is not imposing an income tax on Mr. Bernstein personally; it is taxing "the taxable income of the . . . trust." N.C. Gen. Stat. § 105-160.2

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[3] The Court in *Americold* noted that "when a trustee files a lawsuit or is sued *in her own name*, her citizenship is all that matters for diversity purposes." 136 S. Ct. at 1016 (emphasis added). Here, however, only the Trust is the plaintiff. The trustee is not a party.

[4] A number of amici apply this same mistaken premise. *See, e.g.*, Prof. Brilmayer Br. 11, 17–21; Chamber of Commerce Br. 3, 15–17.

(2017). That is why the Trust—and not Mr. Bernstein—is the plaintiff in this lawsuit.

In the decision under review, the state supreme court agreed that the statute taxes trusts, not trustees. Pet. App. 4a. The court described the trustee as the person who "physically" sends in the tax payment on behalf of the trust. Pet. App. 12a (citing N.C. Gen. Stat. § 105-160.2).

Despite all this, the Trust claims that "the trustee is liable for taxes assessed on the trust." Resp't's Br. 37. It cites a treatise for that proposition. *See* Myron Kove, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* § 265, at 130 (rev. 3d ed. 2012) [hereinafter Bogert]. That section of the treatise, however, says the opposite: "[T]he trustee is *not* personally liable for income taxes assessed on the trust's taxable income." *Ibid.* (emphasis added).

Citing the same section, the Trust also claims that "the trustee is liable . . . for failure to file returns or pay taxes." Resp't's Br. 37 (citing Bogert, *supra*, § 265). Again, however, that section says the opposite: Unpaid trust taxes are "collectible from the trust estate . . . but *not* from the personal estate of the trustee." Bogert, *supra*, § 265, at 128 (emphasis added).[5]

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[5] The Trust also cites the Uniform Trust Code. Resp't's Br. 37 (citing Unif. Trust Code § 816 (Unif. Law Comm'n 2000)). But the cited code section states only that a trustee is authorized to remit taxes on the trust's behalf, not that the trustee pays those taxes with his own money. Unif. Trust Code § 816.

As these points show, North Carolina did not tax the trustee here. That false premise undermines the Trust's argument that a due-process analysis should be limited to the trustee's contacts alone.

* * *

In sum, the two major premises of the Trust's arguments are false. The failure of those premises shows why a trustee's contacts are not the only contacts that count for due-process purposes. Instead, as shown above and in the Department's opening brief, the beneficiary—the trust's central figure—has the most important jurisdictional contacts. Pet'r's Br. 29–33; *supra* pp. 4–7.

II. The Trust misunderstands this Court's decisions on due process and taxation.

A. The Trust's reliance on *Pennoyer*-era cases is mistaken.

The Trust begins its doctrinal arguments by emphasizing two of this Court's *Pennoyer*-era decisions: *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929), and *Brooke v. City of Norfolk*, 277 U.S. 27 (1928). For several reasons, those cases do not carry the day here.

First, those cases applied a physical-presence test that is inconsistent with modern due-process analysis.

Safe Deposit demanded that the trust assets at issue be "actual[ly] presen[t]" in the taxing state. 280 U.S. at 92. The majority opinion uses the word "situs" ten times. *Id.* at 91–94.

Brooke, too, relies on presence-based reasoning. The *Brooke* Court found it pivotal that "the property held in trust has remained in Maryland and no part of it is or ever has been in Virginia." 277 U.S. at 28.

These presence-focused cases have been "superseded by developments in the law of due process." *Quill*, 504 U.S. at 308. Twice within the last five years, the Court has cautioned that *Pennoyer*-era precedents "should not attract heavy reliance today." *Daimler AG v. Bauman*, 571 U.S. 117, 138 n.18 (2014); *accord BNSF Ry. Co. v. Tyrrell*, 137 S. Ct. 1549, 1557–58 (2017).

The Trust tries to shore up *Safe Deposit* and *Brooke* by arguing that they reflect a "practical realit[y]" that the trustee is the one true owner of a beneficiary's trust income. Resp't's Br. 18. That explanation, however, overlooks the actual reasoning in *Safe Deposit* and *Brooke*—reasoning that focuses on physical presence, not economic reality. *See supra* p. 12.

More importantly, the Trust's view of practical reality is the opposite of the actual reality that this Court recognized in *Stone*: the reality that trust money is "the beneficiary's money." 301 U.S. at 535; *see supra* pp. 4–7.

In sum, the Trust's argument contradicts first principles of trust law, as well as this Court's later decisions in *Stewart*, *Blair*, and, most notably, *Stone*.[6]

The Trust's reliance on *Safe Deposit* and *Brooke* is misplaced for a second reason as well: Even aside from their *Pennoyer*-era reasoning, these cases have been separately undercut by later decisions.

Safe Deposit relies heavily on the idea that the Due Process Clause bars taxation by more than one

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[6] The Trust also tries to refigure *Greenough* as a case that calls a trustee the one true owner of trust assets. Resp't's Br. 21–22. *Greenough* does not endorse the Trust's view. The *Greenough* Court explicitly based its holding on the benefits and protections that the taxing state provided to the trust. The Court expressly "restrict[ed its] discussion and determination" to rejecting the argument that Rhode Island offered no "protection of or benefit to the trust fund." *Greenough*, 331 U.S. at 490.

state. That doctrine was overruled in *Curry v. McCanless*, 307 U.S. 357, 363 (1939).

The Trust's only answer to *Curry* is to point out that the Court's analysis of double taxation started to shift even earlier. Resp't's Br. 19 n.3. But that point only highlights that *Safe Deposit* was infirm before *Curry* dealt the fatal blow.[7]

Brooke, another *Pennoyer*-era decision, suffered a similar fate. There, the Court held that the Due Process Clause bars a state from taxing beneficiaries on trust property that is not physically present in that state. 277 U.S. at 29. Thirteen years later, however, the Court reversed course.

In *Stewart*, the Court affirmed a state supreme court's decision that the Due Process Clause *allows* a state to tax beneficiaries on trust property that is not physically present there. 12 A.2d at 446–47, *aff'd mem.*, 312 U.S. 649. Over the dissent of Justice McReynolds, the author of the majority opinion in *Safe Deposit*, the Court held that Pennsylvania could tax a resident beneficiary on her equitable interest in a trust—the same property interest that makes Ms.

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[7] Although the Trust admits that *Safe Deposit*'s double-taxation reasoning is no longer good law, the Trust still complains that the tax here could produce double taxation. Resp't's Br. 19 n.3. The Trust, however, does not claim that any actual double taxation happened here. During the tax years at issue, the Trust paid virtually no trust-income tax in any state except North Carolina. Pet'r's Br. 43–45.

Kaestner the true owner of her trust income here. *See supra* pp. 4–7.

The Trust does not address *Stewart* at all.

Finally, *Safe Deposit* and *Brooke* are distinguishable because they both involved property taxes. *Safe Deposit*, 280 U.S. at 90; *Brooke*, 277 U.S. at 28. This case, in contrast, involves income taxes.

For due-process purposes, the Court has long distinguished property taxes from income taxes. *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 314 (1937); *accord Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 187–88 (1983); *Greenough*, 331 U.S. at 491–92.

Property taxes and income taxes are "predicated upon different governmental benefits." *Graves*, 300 U.S. at 314. Property taxes are constitutional because a state protects property itself. *Container Corp.*, 463 U.S. at 188. Income taxes, in contrast, are "founded upon the [state's] protection afforded to the recipient of the income." *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 281 (1932).

Because of this difference, the Court has cautioned that the "single situs" reasoning that often applies to property taxation should "carry little force in the case of income taxation." *Container Corp.*, 463 U.S. at 188 (quoting *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 445 (1980)). Under this principle, the single-situs reasoning in *Safe Deposit* and *Brooke* carries little force here. Tax Profs.' Br. 16–18.

In sum, *Safe Deposit* and *Brooke* offer no guidance on the question presented.

B. The Court's decisions in *Hanson* and *Shaffer* do not control.

1. *Hanson* is inapposite here.

The Trust argues that *Hanson v. Denckla*, 357 U.S. 235 (1958), controls this case. Resp't's Br. 23–30. That argument fails for at least three reasons.

First, *Hanson* is distinguishable because it involved jurisdiction over a trustee, not a trust. 357 U.S. at 254–55. The issue in *Hanson* was whether a Delaware trustee could be haled into a Florida court in a will contest. *Ibid.*

Here, the Department is not seeking to hale the trustee, Mr. Bernstein, across state lines. Instead, North Carolina taxed a resident beneficiary's *trust* on income that was generated exclusively for her benefit. For this reason, *Hanson* is inapposite.

Second, *Hanson* is distinguishable because the state imposition there was felt only by a nonresident of the forum state: the Delaware trustee. *Ibid.*

Here, in contrast, the imposition is ultimately felt by an *in-state* resident. As shown above, "only [the beneficiary] is ultimately burdened" by trust taxes. *Stone*, 301 U.S. at 538; *see supra* pp. 4–7. In economic terms, the taxes here affected only Ms. Kaestner, a North Carolinian.

Third, *Hanson* is distinguishable because the imposition there involved the burdens of being sued. *See Phillips Petroleum, Inc. v. Shutts*, 472 U.S. 797, 808 (1985) (describing these burdens). This case, in contrast, involves a tax—a purely economic imposition.[8] This imposition is limited, moreover, to "the amount of the taxable income . . . that is for the benefit of a resident of [North Carolina]." N.C. Gen. Stat. § 105-160.2.

For these reasons, the Trust's reliance on *Hanson* is misplaced.

2. *Shaffer* does not help the Trust here.

The Trust also relies on *Shaffer v. Heitner*, 433 U.S. 186 (1977). Resp't's Br. 47–49. The Trust argues that *Shaffer* stands for the broad proposition that "the acceptance of fiduciary obligations to a forum resident" does not support jurisdiction. *Id.* at 48.

The Court in *Shaffer* specifically noted, however, that the case did not involve a fiduciary-duty theory of jurisdiction. The Court stressed that the relevant statute based jurisdiction "not on [the defendants'] status as corporate fiduciaries, but rather on the presence of their property in the State." 433 U.S. at 214. It was that quasi-in-rem theory, not a theory based

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[8] The Trust and its amici are right that this Court's decisions on adjudicative jurisdiction have helped shape tax jurisdiction. *Hanson*, however, illustrates a key difference between these two doctrines—the nature of the imposition involved.

on fiduciary relationships, that the *Shaffer* Court rejected.

Moreover, the Trust's broad reading of *Shaffer* cannot be squared with *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 473 (1985), which held that an extensive contractual relationship can justify jurisdiction over a person. Nor can it be squared with *Scripto, Inc. v. Carson*, 362 U.S. 207, 211 (1960), which based jurisdiction on a relationship with in-state independent contractors.

Here, a trust's relationship with its beneficiary is at least as close as the relationships in *Burger King* and *Scripto*.[9] Indeed, a trust exists to serve its beneficiary; it cannot exist without her. Pet'r's Br. 29–30.

For these reasons, the Trust's arguments based on *Shaffer* are mistaken.

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In sum, the Court's due-process decisions do not support the Trust's effort to narrow the scope of trust taxation.

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[9] The Trust's reliance on *Kulko v. Superior Court*, 436 U.S. 84 (1978), fares no better. There, the defendant father's only relevant contact with California was that he allowed his daughter to live there with her mother. *Id.* at 92–93. The Court rejected this strained theory of a contact because it would "discourag[e] parents from entering into reasonable visitation agreements." *Id.* at 93. That concern has no relevance here.

III. The Trust's remaining arguments fail.

A. The Trust's new arguments do not succeed.

1. Tax jurisdiction does not depend on whether trust income is distributed.

The Trust argues that the fact that Ms. Kaestner did not receive distributions during the years at issue is constitutionally pivotal. *E.g.*, Resp't's Br. 8, 17. The Trust bases this argument on *Brooke v. City of Norfolk*, 277 U.S. 27 (1928). Resp't's Br. 16–17, 20–23.

Here, again, the Trust does not mention this Court's affirmance in *Commonwealth v. Stewart*, 12 A.2d 444 (Pa. 1940), *aff'd mem.*, 312 U.S. 649 (1941).

Stewart held that due process allowed a state to tax a resident beneficiary on *undistributed* trust assets. *Id.* at 447. *Stewart* cited two reasons why distributions are not constitutionally pivotal.

First, even though a trustee formally holds undistributed trust assets, a beneficiary's equitable interest in those assets provides the connection that justifies tax jurisdiction. *Id.* at 450. Ms. Kaestner holds this same equitable interest here. *See supra* pp. 4–7.

Second, when a trust accumulates trust assets, a trust beneficiary's home state "affords her the personal security that enables her to enjoy those resources." *Stewart*, 12 A.2d at 451. The Court expanded this principle in *Greenough*, 331 U.S. at 495. There, the Court held that it does not matter whether a trust constituent actually uses the state's benefits and

protections; all that matters is that she has the *opportunity* to do so. *Ibid.*

Here, during all of the tax years at issue, Ms. Kaestner and her children lived in North Carolina, enjoying taxpayer-funded benefits and protections. Pet'r's Br. 30–36. Whether the Trust made distributions or not, the state's protection of the Kaestners benefited the Trust. *Id.* at 33–36.

For example, North Carolina's regulation of banking gave the Trust the opportunity to make secure distributions and loans to Ms. Kaestner. *Id.* at 36. The Trust used that opportunity: It made a loan to Ms. Kaestner just a month after the tax period here. Pet. App. 3a. A few years later, it distributed trust assets to her. N.C. R. 214–15.

Finally, the Trust's "no distributions" argument overlooks the context in which the Trust was accumulating income.

A trust accumulates income for one purpose: eventually distributing that income to the beneficiary. *See supra* pp. 4–7. Here, Ms. Kaestner eventually received assets from the Trust. N.C. R. 214–15. If she had wanted to receive the trust assets sooner, in June 2009, she would have received them then. Those assets were decanted into a new trust only after consultation with Ms. Kaestner. App. 97; Pet'r's Br. 9–10.

In addition, a trust's accumulation of income has immediate benefits for the beneficiary. As noted above, trusts can make low-interest-rate loans to

beneficiaries, allowing them to enjoy the trust's accumulated income without paying any personal income tax. Tax Profs.' Br. 20–21. That is exactly what happened here. Pet. App. 3a; App. 99–100, 113.

Because of these realities, the Trust is wrong to treat income distributions as constitutionally pivotal.

2. The Trust's "no purposeful availment" argument is mistaken.

The Trust argues that jurisdiction is lacking because Mr. Bernstein did not purposefully avail himself of the taxing state. Resp't's Br. 12–15, 34, 47–49.

That argument fails because North Carolina did not tax Mr. Bernstein; it taxed the Trust. *See supra* pp. 8–11. The economic effect of the tax was felt only by Ms. Kaestner, a North Carolinian. *See Stone*, 301 U.S. at 538; *supra* pp. 4–7.

Moreover, the Trust's argument assumes that the only purposeful availment that counts for the Trust is the trustee's purposeful availment. Instead, just as the contacts that count for due-process purposes are those of the trust constituents, a trust's purposeful availment takes place through a trust constituent—the grantor, the trustee, or the beneficiary. *See Greenough*, 331 U.S. at 495; Pet'r's Br. 25–28.

Under that principle, the Trust purposefully availed itself of North Carolina. The Trust's central constituent, Ms. Kaestner, was a North Carolina

resident throughout the tax years at issue. As a resident, Ms. Kaestner enjoyed extensive benefits and protections from the state. Pet'r's Br. 30–36. Those state benefits and protections benefited the Trust in multiple ways—most notably, by helping the Trust conserve its income. *Id.* at 33–36. The Trust leaves that argument unanswered.

Indeed, North Carolina protected Ms. Kaestner throughout the life of the Trust. When the Kaestner Trust was created, Ms. Kaestner had been living in North Carolina for years.[10] Pet. App. 2a–3a.

By that time, moreover, North Carolina's trust-tax statute had been on the books for more than 75 years. The statute explicitly taxes trust income "that is for the benefit of a resident of [North Carolina]." N.C. Gen. Stat. § 105-160.2. This statutory language gave the Trust and its constituents fair warning that the Trust would be taxed in North Carolina. *See Quill*, 504 U.S. at 312 ("We have . . . often identified 'notice' or 'fair

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[10] The Trust was split off from the Rice Family Trust in 2002 and formally established as a separate trust in 2006. Pet'r's Br. 7–8; Pet. App. 3a. Ms. Kaestner moved to North Carolina in 1997. Pet. App. 2a–3a.

Thus, Professor Brilmayer's arguments about the Trust apply a mistaken factual assumption: that Ms. Kaestner moved to North Carolina "well after the Trust was established." Prof. Brilmayer Br. 2; *see id.* at i, 3–4, 15 n.5, 17, 24–27.

The source of this mistaken assumption may be the Trust's inaccurate statement that Ms. Kaestner moved to North Carolina "five years after the trust's creation." Resp't's Br. 7. In actuality, the Kaestner Trust was created years after Ms. Kaestner moved to North Carolina.

warning' as the analytic touchstone of due process nexus analysis.").

Finally, even if one accepted the Trust's theory that Mr. Bernstein's purposeful availment is the only purposeful availment that matters, this case would still show purposeful availment. Resp't's Br. 34. When all of a trust's beneficiaries live in a given state, a trustee's fiduciary duty requires him to direct all of his efforts toward residents of that state. Tax Profs.' Br. 9.

For these reasons, the Trust's "no purposeful availment" argument fails.

3. The Trust's "absolute discretion" argument is contrary to trust law.

The Trust argues that the Trust lacked a minimum connection to North Carolina because the trustee had "absolute discretion" to treat Ms. Kaestner as he saw fit. Resp't's Br. 14, 45, 49. That argument exaggerates the trustee's discretion and its relevance here.

First, the Trust's "absolute discretion" argument misses the point. What matters for due-process purposes is whether a resident beneficiary is *eligible* to receive distributions at the time of the tax. *See supra* pp. 19–21. When a beneficiary is eligible for distributions, state services to the beneficiary benefit the trust. Pet'r's Br. 33–36. These state services help a trust conserve its income and garner investment returns. *Id.* at 31–32. Here, throughout the tax years

at issue, Ms. Kaestner and her children were the only people eligible for distributions from the Trust. *See* App. 46–47 (art. 1.2(a)–(b)).

In any event, the term "absolute discretion" in a trust instrument is not taken literally. Trust Profs.' Br. 13 n.5 (summarizing authorities). Instead, a trustee's fiduciary duty to trust beneficiaries limits his discretion. *Ibid.*

Even when a trust instrument gives trustees "sole and absolute discretion" to make distributions, it is "unacceptable for trustees to simply sit back and do nothing until a request is made." *In re Andrew C.*, 2017 WL 6821717, at *1 (N.Y. Sur. Ct. 2017).[11] Instead, trust law gives trustees "an affirmative duty to inquire with diligence into the quality of [a beneficiary's] life and to apply trust income towards significantly improving it."[12] *Ibid.*

Thus, if North Carolina had not protected Ms. Kaestner during the years at issue, Mr. Bernstein's fiduciary duties would have called for him to make distributions to meet her needs. If he refused those distributions on the ground that his "absolute discretion" did not require them, Ms. Kaestner would

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[11] Here, the trust instrument states that New York law governs its interpretation. App. 69 (art. 10).

[12] The trust instrument here reinforced these duties. It "direct[ed]" the trustee to consider the trust "a family asset, and to be liberal in the exercise of the discretion conferred upon [him] and to use income and principal . . . to meet the needs of the beneficiaries." App. 51 (art. 1.4(c)).

have had a claim for breach of fiduciary duty. *See, e.g.*, *ibid.*

As these points show, the Trust's assertion that Mr. Bernstein "had no legal obligation to provide anything to [Ms. Kaestner] during the relevant period," Resp't's Br. 45, is irrelevant to a due-process analysis and contrary to trust law.

B. The Trust has not justified its proposed tax shelter.

The Trust's arguments here, if successful, would open up a massive tax shelter—an outcome that this Court recently rejected. *See South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2094 (2018).

Under the Trust's proposed rule, to avoid state income taxes nationwide, all one would need to do is select a trustee in a state with no trust-income tax.[13]

The Trust responds with two alleged justifications for this tax shelter. Both fail.

First, the Trust argues that the Department is questioning other states' taxing choices. Not so. It is simply asking the Court to honor North Carolina's *own* taxing choices. The Department is also showing why

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[13] To try to make this tax shelter seem smaller, the Trust suggests that states might enact a "throwback" rule. Resp't's Br. 51–52. A throwback rule, however, would still allow beneficiaries like Ms. Kaestner to avoid state taxes on all of their trust income. All the beneficiaries would need to do is move to a strategically chosen state before taking a distribution. Pet'r's Br. 40.

North Carolina's tax is fundamentally fair—the central focus of the "minimum connection" test. *See Quill*, 504 U.S. at 306.[14]

The Department is also pointing out the practical consequences of the Trust's proposed rule: "significant revenue losses to the States." *Wayfair*, 138 S. Ct. at 2092. Avoiding those consequences would protect the same interest that the Trust claims to support: "the sovereign right of each state to set its tax policy." Resp't's Br. 15.[15]

The Trust also argues that a decision in its favor would not significantly disrupt states' taxing choices. The Trust is grossly mistaken. Its arguments, if accepted, would invalidate trust-tax statutes in a majority of the states.

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[14] One of the no-trust-tax states, South Dakota, explicitly argues that the trust-tax statutes in the majority of its sister states should fall so that South Dakota can maintain its "comparative economic advantage" and attract "the trust industry." S.D. Br. 1, 3; *see id.* at 7–8. Crediting arguments like those would create a race to the bottom in trust taxation—an effect that would insulate wide swaths of trust income from state taxes. Pet'r's Br. 39–43; Tax Profs.' Br. 18–25.

[15] The Trust and its amici suggest that the Department's arguments would allow corporations to be haled into court in states where their shareholders live. Resp't's Br. 56–57; Chamber Br. 1. Those concerns are unfounded.

The Department's argument applies only to trusts—unique arrangements that lack any entity status. Pet'r's Br. 22–25. The argument does not extend to legal entities, like corporations, that are capable of making entity-level contacts. *See Americold*, 136 S. Ct. at 1016.

The Trust is asking this Court to constitutionalize the following rule: Only the state where a trustee lives and the state where a trust is administered have the right to tax undistributed non-source income in a non-grantor trust. *Id.* at 50–51. That rule would not treat a beneficiary's residency or a grantor's residency as a proper jurisdictional connection. *See ibid.*

A majority of states tax trust income on the basis of beneficiary residency, grantor residency, or a set of factors that includes at least one of those connections. Tax Profs.' Br. 18–20; Twenty-one States' Br. 9–12. Thus, if the Court accepted the Trust's proposed rule, that ruling would strike down trust-tax statutes in a majority of states.[16]

In sum, the rule that the Trust seeks here would construct a tax shelter of multi-billion-dollar proportions. Pet'r's Br. 39–43 (describing these concerns further); Tax Profs.' Br. 18–25 (amplifying these concerns).

This Court has not hesitated to reject such a result. *See Wayfair*, 138 S. Ct. at 2100. This case calls for the same outcome.

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[16] Tax Profs.' Br. 19. Indeed, thirty-three states use beneficiaries' residency or grantors' residency as a criterion for taxing trusts. *See* Richard W. Nenno, *Bases of State Income Taxation of Nongrantor Trusts* (Feb. 28, 2019), https://perma.cc/88UZ-Q7ML.

CONCLUSION

The state supreme court's decision should be reversed.

Respectfully submitted,

ROBERT F. ORR
ROBERT F. ORR, PLLC
3434 Edwards Mill Rd.
Suite 112-372
Raleigh, NC 27612
(919) 608-5335

ANDREW H. ERTESCHIK
SAAD GUL
JOHN M. DURNOVICH
NATHANIEL C. ZINKOW
POYNER SPRUILL LLP
Post Office Box 1801
Raleigh, NC 27602
(919) 783-2895

JOSHUA H. STEIN
Attorney General

MATTHEW W. SAWCHAK
Solicitor General
Counsel of Record
JAMES W. DOGGETT
Deputy Solicitor General
RYAN Y. PARK
Deputy Solicitor General
NORTH CAROLINA
DEPARTMENT OF JUSTICE
Post Office Box 629
Raleigh, NC 27602
(919) 716-6400
msawchak@ncdoj.gov

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No. 18-457

IN THE

Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST,

Respondent.

On Writ of Certiorari to the Supreme Court of North Carolina

BRIEF OF AMERICAN COLLEGE OF TAX COUNSEL AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

C. WELLS HALL, III
Counsel of Record
CHARLES H. MERCER, JR.
REED J. HOLLANDER
NELSON MULLINS RILEY & SCARBOROUGH LLP
301 S. College Street
Suite 2300
Charlotte, NC 28202
(704) 417-3000
wells.hall@nelsonmullins.com

Counsel for Amicus Curiae

March 25, 2019

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BRIEF OF AMERICAN COLLEGE OF TAX COUNSEL AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

The American College of Tax Counsel (the "College") respectfully submits this brief as *amicus curiae* in support of Respondent.[1]

STATEMENT OF INTEREST

The College is a nonprofit professional association of tax lawyers in private practice, in law school teaching positions, and in government, who are recognized for their excellence in tax practice and for their substantial contributions and commitment to the profession.[2]

The College is composed of approximately 700 Fellows recognized for their outstanding reputations and contributions to the field of tax law and is governed by a Board of Regents consisting of one Regent from each federal judicial circuit, two Regents at large, the Officers of the College, and the last retiring President of the College. As part of its mission to improve the tax

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[1] Pursuant to Supreme Court Rule 37.6, counsel for *amicus curiae* states that no counsel for a party authored this brief in whole or in part, and no party or counsel for a party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amicus curiae*, its members, or its counsel made a monetary contribution to its preparation or submission. All parties have consented to the filing of this brief.

[2] The purposes of the College are to foster and recognize the excellence of its members and to elevate standards in the practice of the profession of tax law; to stimulate development of skills and knowledge through participation in continuing legal education programs and seminars; to provide additional mechanisms for input by tax professionals in development of tax laws and policy; and to facilitate scholarly discussion and examination of tax policy issues.

system, the College provides recommendations to Congress and the Internal Revenue Service for improving the nation's tax laws and the way that they are interpreted and administered, and it provides input to the Court by filing *amicus* briefs in selected tax cases.[3]

It is the view of the Board of Regents of the College that trustees, settlors, and trust beneficiaries are each distinct entities, while trusts are treated as separate taxable entities for federal and state tax purposes. Exercise of State power over a trust and its trustee based solely on the in-state presence of a contingent trust beneficiary could meet due process requirements only if those important distinctions were disregarded. Such disregard would be contrary to decades of modern jurisdictional precedent. The College submits this *amicus* brief because it is concerned that the position espoused by Petitioner would create tax jurisdiction chaos between states and non-resident sources of potential tax revenue and would have far-reaching and unpredictable consequences for trust administration and advice provided by tax practitioners, including Fellows of the College.

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[3] This *amicus* brief is submitted by the College's Board of Regents and does not necessarily reflect the views of all members of the College, including those who are government employees, academics, and law school professors, some of whom have appeared separately before the Court as *amicus curiae* in this case.

SUMMARY OF ARGUMENT

Both this Court's jurisprudence and North Carolina law recognize that Due Process Clause personal jurisdiction over nonresident trustees and the assets they manage should be exercised by the State in which the trust is managed and administered, not the States in which beneficiaries may reside. The relationship between trustee and beneficiary, standing alone, does not permit exercise of jurisdiction over the nonresident trustee by the State of domicile of a trust beneficiary.

Nothing in *South Dakota v. Wayfair*, 138 S. Ct. 2080 (2018), changed this fundamental Due Process principle. *Wayfair* brought the application of the Commerce Clause for sales taxes in line with other forms of State taxation by recognizing that there was no longer any basis for a physical-presence nexus requirement exclusive to sales tax. The essential Due Process mandate set forth in *Quill Corp. v. N.D.*, 504 U.S. 298 (1992), growing from *Int'l Shoe Co. v. Wash.*, 326 U.S. 310 (1945), that the "person, property, or transaction" sought to be taxed must have "purposefully availed" itself of the forum State, stands unchanged by *Wayfair*. The lower court's decision properly applied that long-standing Due Process requirement to determine that the nonresident trustee lacked a definite connection to North Carolina. Rather than "modernizing" trust taxation, Petitioner's position invents a new nexus rule specific to trusts that exists nowhere else in the Court's tax nexus jurisprudence. Such a rule would invite analogous tax treatment of nonresident corporations and other entities solely based on their relationships with in-state shareholders or interest owners, a result that this Court has never reached.

Multiple precedents of this Court would need to be re-evaluated, and likely overruled, in order to reach

the result sought by Petitioner, including the seminal decision of *Hanson v. Denckla*, 357 U.S. 235 (1958). Since this Court's jurisdiction-to-tax case law grows from the same roots that form the *in personam* and *in rem* jurisdictional framework described in *Hanson*, it would be unwise to create a variant jurisdictional test allowing North Carolina to exercise tax jurisdiction over a nonresident trustee over whom it does not have adjudicative jurisdiction.

Moreover, fracturing this Court's jurisprudence on minimum contacts to draw a distinction between adjudicative jurisdiction and prescriptive or tax jurisdiction, solely to permit the State to reach income earned out of state which was never distributed to any in-state beneficiary, is an unnecessary and ill-advised expansion of the Due Process Clause's jurisdictional limits. Examination of the North Carolina trust tax law and of the trust instrument in this case further illuminates why the income of the trust must be attributed to the trustee, not to a contingent beneficiary, and be subject to tax only by the State in which the trustee resided and purposefully availed himself.

Finally, the state-tax revenue loss assertion by Petitioner is a misnomer. State tax revenue is an expected consequence of choices made by each State regarding the structure of its tax system, and the responses of each citizen to the incentives created through those tax systems. Connecticut's choice to limit the scope of its taxation of resident trusts does not empower North Carolina to exercise State tax authority beyond its borders.

ARGUMENT

I. PERSONAL JURISDICTION OVER NON-RESIDENT TRUSTEES, AND THE TRUST ASSETS THEY OWN, IS EXERCISED BY THE STATE IN WHICH THE TRUST IS MANAGED AND ADMINISTERED, NOT THE STATES IN WHICH BENEFICIARIES RESIDE.

"A trust is a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee." Restatement (Third) of Trusts, § 2 (2003). At least 31 states and the District of Columbia have adopted the Uniform Trust Code ("UTC"), promulgated by the National Conference of Commissioners on Uniform State Laws.[4] Many of the states that have not adopted the UTC have already in place comprehensive State codes regulating trusts and trustees. *Id.*

Under the UTC, the key figure for assessing personal jurisdiction over a trust is the trustee. A trustee submits personally to the jurisdiction of a State court regarding any matter involving the trust if the trust's

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[4] The adopting states are Alabama, Arizona, Arkansas, Florida, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Mississippi, Missouri, Minnesota, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Utah, Vermont, Virginia, West Virginia, and Wyoming. *See* GEORGE C. BOGERT ET AL., THE LAW OF TRUSTS AND TRUSTEES: A TREATISE COVERING THE LAW RELATING TO TRUSTS AND ALLIED SUBJECTS AFFECTING TRUST CREATION AND ADMINISTRATION, WITH FORMS, § 7 (3rd ed. 2001, July 2018 update).

principal place of administration is in the forum State. U.T.C. § 202 (2010), (*codified in North Carolina at* N.C. Gen. Stat. § 36C-2-202(a) (2005)). Beneficiaries of a trust with its principal place of administration in a State are subject to the jurisdiction of that State for any matters involving the trust. *Id.* While this provision of the North Carolina trust statute purports to subject the beneficiary to the jurisdiction of the State where the administration of the trust occurs, no provision of the North Carolina statute or the UTC would purport to subject a trustee (or a trust) to the jurisdiction of the State where the beneficiary resides, unless some other basis for jurisdiction existed.[5]

Had a dispute arisen between Ms. Kaestner and the trustee, Ms. Kaestner's claim would have been properly brought in the state or federal courts of the State of administration of the trust, not in North Carolina's courts. North Carolina's codification of the UTC would not permit a North Carolina court to exercise personal jurisdiction over a trustee administering the Kaestner Trust in New York so long as no other basis for personal jurisdiction existed.

This statutory scheme is not merely a result of legislative policy, but also a recognition of the Due Process Clause limits on the exercise of state power over nonresident trusts and their trustees – a principle well-recognized by North Carolina's courts. In *Skinner v. Preferred Credit*, 638 S.E.2d 203 (N.C. 2006), the Supreme Court of North Carolina considered whether the State had specific jurisdiction over a nonresident mortgage loan trust defendant when (1) the trust held

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[5] The UTC "does not preclude other methods of obtaining jurisdiction over a trustee, beneficiary, or other person receiving property from the trust." N.C. Gen. Stat. § 36C-2-202(c) (2005).

a loan originated in North Carolina; (2) the trust owned a deed of trust on North Carolina property; and (3) loan payments from North Carolina were deposited into the trust on a systematic basis. Even with these contacts between in-state residents and a nonresident mortgage loan trust, the North Carolina Supreme Court held that there were insufficient contacts under the Due Process Clause to allow exercise of jurisdiction over the nonresident trust. *Id.* at 213, applying *Int'l. Shoe Co. v. Wash.*, 326 U.S. 310 (1945).

The evidence presented in *Skinner* failed to establish minimum contacts because (1) the Trust was created outside the State, had its day-to-day operations in New York, and only 3% of its loan assets had ties to North Carolina; (2) the North Carolina interest held by the Trust was "simply a beneficial interest" in North Carolina property – the trust did not hold title to any North Carolina property; and (3) the trust served as a depository for income received by the loan servicer from North Carolina, among other states. The court explained that its cases analyzing minimum contacts "rarely have dealt with so 'passive' a defendant." *Id.* at 211. It compared the nonresident mortgage trust's contacts to those in a case concerning a nonresident person who signed a conditional promissory note guaranteeing a debt to a North Carolina company, but who had no other contacts with the State. The court held such contacts were also insufficient for the nonresident guarantor on the note to be made a defendant in a North Carolina action. Even though "the defendant signed a note that created a relationship with North Carolina residents, [the court] could not automatically exercise personal jurisdiction." *Id.*, citing *United Buying Group, Inc. v. Coleman*, 251 S.E.2d 610 (1979). The trustee's "relationship" with Ms. Kaestner

is similarly insufficient for North Carolina to exercise personal jurisdiction over the trust.

The goals of "minimum contacts" jurisprudence are to "safeguard[] the defendant from being required to defend an action in a distant or inconvenient forum" and to "prevent[] a state from escaping the restraints imposed upon it by its status as a coequal sovereign in a federal system." *Skinner,* 638 S.E.2d at 210 (citing *Miller v. Kite*, 329 S.E.2d 663, 665 (N.C. 1985) (citing *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286 (1980).)) Part and parcel of the minimum contacts principle is that the contacts at issue must be those of the "person, property or transaction," *Quill*, 504 U.S. at 306, being subjected to the tax. The contacts of related entities are not attributed to the party over whom the State seeks to exert its power. *Brooke v. City of Norfolk*, 277 U.S. 27 (1928) (residency of a trust beneficiary was not attributed to the nonresident trustee).

In the context of a nongrantor discretionary trust with contingent[6] beneficiaries, it is particularly inappropriate to attribute the contacts of the beneficiary to the trust or the trustee. The beneficiary has no authority to direct the actions of the trustee. Absent an abuse of *discretion* on the part of the trustee, Ms. Kaestner possessed no legally enforceable right of any kind over

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[6] Because Ms. Kaestner did not have a right under the Trust to receive all or a portion of the income generated by the Trust assets in a particular year or on demand, her interest was contingent in nature until the conditions precedent to receipt of income were satisfied – in this case, the exercise of the absolute discretion of the trustee. *See* Trust Agmt. §1.2(a), JA at 47, further discussed at Section II.D., *infra* and Amicus Brief of American College of Trust and Estate Counsel ("ACTEC") at 8.

the actions of the trustee or the control, disposition, or deployment of the Family Trust assets.[7]

Receiving a distribution is certainly a taxable event in the State in which the recipient beneficiary resides. For example, the power of Virginia to tax a trust *distribution* received by a Virginia resident from a New York trust, after the trust's income had already been taxed by New York, was recognized in *Guaranty Trust Co. of N.Y. v. Va.*, 305 U.S. 19 (1938), and was based on Virginia's power under the Due Process Clause "to tax something done within her borders." *Id.* at 23. ("[T]he taxing power of a state is restricted to her confines and may not be exercised in respect of subjects beyond them. Here, the thing taxed was receipt of [nonresident trust] income within Virginia by a citizen residing there.") Of course, unlike the beneficiary in *Guaranty Trust*, Ms. Kaestner received no distributions during the tax years at issue.

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[7] Attributional nexus cases, such as *Tyler Pipe Ind., Inc. v. Wash. State Dept. of Revenue*, 483 U.S. 232 (1987) and *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), rely on in-state activities by employees or agents of companies to create nexus to an otherwise out-of-state company. Since Ms. Kaestner took no actions in North Carolina that could be attributed to the Trust or trustee, the State cannot rely on attributional nexus.

II. STATES MAY ONLY EXERCISE TAXING POWER OVER NONRESIDENT ENTITIES WHO HAVE A DEFINITE LINK OR MINIMUM CONNECTION TO THE TAXING STATE.

A. *South Dakota v. Wayfair* Underscores the Due Process Clause's Requirement that a Taxed Entity Must Have "Purposefully Availed" Itself of the Taxing State.

South Dakota v. Wayfair, 138 S. Ct. 2080 (2018), harmonized the Court's Commerce Clause jurisprudence as applied to so-called "remote seller" sales tax cases by holding that in-state physical presence was no longer a mandatory prerequisite to the exercise of State sales taxing power under the Commerce Clause. In so holding, however, *Wayfair* made no change to the Court's long-standing views on Due Process Clause nexus for the exercise of State taxing power.[8]

In *Quill*, the Court explained that the Due Process Clause requires "some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax," *Quill*, 504 U.S. at 306 (citing *Miller Brothers Co. v. M.S.*, 347 U.S. 340, 344-345 (1954)), "and that the income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State.'" *Quill*, 504 U.S. at 307 (emphasis added) (citing *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978)).[9]

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[8] *Quill* recognized that States had Due Process nexus to impose a sales tax on out-of-state vendors for sales purposely directed to that State's residents.

[9] Petitioner's Brief at 15 inaccurately states the test established in *Quill*, claiming that the Trust must show that both

The first of these two tests was analyzed by a flexible inquiry directed at whether the contacts between the entity and the forum State made it reasonable to require the entity to defend itself in that State. *Quill*, 504 U.S. at 307 (applying *Int'l Shoe*, 326 U.S. 310). This test applies for both *in personam* and *in rem* jurisdiction after *Shaffer v. Heitner*, 433 U.S. 186 (1977).

Applying this test in the tax context, *Quill* explained that a foreign corporation that "purposefully avails" itself of the forum State would subject itself to *in personam* jurisdiction under the Due Process Clause even if it has no physical contact with the State. *Quill*, 504 U.S. at 307-308 (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985)). A "mail-order house that is engaged in continuous and widespread solicitation of business within a State" meets the purposeful availment test, giving the State authority under the Due Process Clause to exercise its taxing power over that corporation. *Quill*, 504 U.S. at 308.

Essential to this analysis is a critical focus on who is "the person, property, or transaction [North Carolina] seeks to tax." *Quill*, 504 U.S. at 306. Petitioner undertakes a substantial effort to make it appear as if it is taxing the beneficiary, focusing substantially on the beneficiary's presence in the State and arguing that the incidence of the tax falls upon the beneficiary. But

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prongs of the Due Process Clause test in *Quill* are not met. Instead, the College submits that it is the burden of the party exerting jurisdiction to prove that its claimed authority meets both prongs: "some definite link, some minimum connection" with "the person, property, or transaction it seeks to tax" and that the "income [is] rationally related to values of the taxing state." If either of these prongs of the test is not met, the taxing authority has exceeded the jurisdictional limits set by the Due Process Clause. *Quill*, 504 U.S. at 306.

the *thing* being taxed here is not the beneficiary and is not the income of the beneficiary; rather, it is the income of the trust in the legal possession of the trustee.

N.C. Gen. Stat. § 105-160.2 levies income tax on "the taxable income of estates and trusts." Income is defined by cross-reference to the Internal Revenue Code (subject to certain state-specific adjustments). The North Carolina statute provides that

> [t]he tax is computed on the amount of the taxable income of the estate or trust *that is for the benefit of a resident of this State*, or for the benefit of a nonresident to the extent that the income (i) is derived from North Carolina sources and is attributable to the ownership of any interest in real or tangible personal property in this State or (ii) is derived from a business, trade, profession, or occupation carried on in this State. . . . The fiduciary responsible for administering the estate or trust shall pay the tax computed under the provisions of this Part.

N.C. Gen. Stat. 105-160.2 (2017) (*emphasis added*).

The North Carolina statute further requires that the trust's fiduciary – not the beneficiary – pay the tax and that the trust's fiduciary file the return, including for trusts "which the Secretary believes to be liable for a tax under this Part, when so notified by the Secretary and requested to file a return."[10]

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[10] A nonresident trustee lacking minimum contacts who does not file a trust tax return upon notice of the Secretary would not be subject to the personal jurisdiction of the North Carolina courts to enforce such a requirement. *Hanson*, 357 U.S.at 235. If the State has no adjudicative jurisdiction over the trustee, there

There is no Due Process minimum connection where a trust has engaged in no business in North Carolina, has held no assets in North Carolina, has no trustee or trust office in North Carolina, and otherwise has no connection to North Carolina. Presence of a contingent beneficiary in the State does not cause the trust to have minimum contacts with North Carolina, just the same as the presence of a shareholder in a State does not cause a corporation to have minimum contacts in a forum State.

B. A Nonresident Trustee Does Not "Purposefully Avail" Himself, or the Trust He Manages, of the Jurisdiction of a Foreign State Simply Due to the Presence of an In-State Beneficiary.

Applying the legal framework established in *Quill*, it is evident that nonresident trustees do not "purposefully avail" themselves to the jurisdiction of a foreign state merely due to the presence of an in-state beneficiary.

A trust, through its trustee, will be expected to engage in acts designed to fulfill the purposes of the trust instrument in compliance with the fiduciary duties imposed upon the trustee and the legal obligations of the trust's governing law. The trustee engages in financial and business transactions on behalf of the trust as appropriate to the goals of the trust. In so doing, the trustee makes decisions about where to conduct the trust's business, how to generate income for the trust, in which investments or other financial transactions to engage, and where and how to acquire,

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is no enforcement mechanism for the asserted tax. *See* Section IV, *infra*.

hold, or divest trust property. Each of those decisions may cause the trust assets or the trustee to become involved in business activities in one or more states.

Similarly, a corporation's directors and officers operate under fiduciary obligations to the corporation's shareholders.[11] They engage in business and financial transactions to conduct business for the purpose of maximizing shareholder value. The corporation's business activities cause the corporation to generate income, which may be retained and re-invested in the corporation's business activities or may be distributed to shareholders.

The essential requirement that a corporation must have shareholders, just as a trust must have beneficiaries, has never led the Court to conclude that a corporation has minimum contacts with a State solely based on the residence of a corporate shareholder. Rather, the Court's due process holdings establish that a shareholder's State of residency is not imputed to the corporation for purposes of that corporation's minimum contacts. *Shaffer*, 433 U.S. at 213 (determining that stock holdings in a corporation, which are not the subject matter of the litigation and are unrelated to the underlying cause of action, do not provide contacts sufficient to support personal jurisdiction). A corporation having no contacts with the State of North Carolina other than the in-state residence of a shareholder could not, under the Due Process Clause, be subject to corporate income tax in North Carolina.

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[11] The Official Comment to Section 8.30 (Standards of Conduct for Directors) of the Model Business Corporation Act of 2016 states that "[t]he standards of conduct for directors established by section 8.30 are analogous to those generally articulated by courts in evaluating director conduct, often referred to as the duties of care and loyalty." MODEL BUS. CORP. ACT § 8.30 (2016).

Just as "it strains reason . . . to suggest that anyone buying securities in a corporation formed in [a State] impliedly consents to subject himself to [that State's] jurisdiction," so too the corporation cannot be hauled into a State's court merely due to the ownership of its stock by an in-State shareholder. *Id.*

A corporation would have to direct its business activities purposefully into a State in order to subject itself to personal jurisdiction, including tax jurisdiction, in that State. *Burger King*, 471 U.S. at 472-473. There is a substantial risk that a decision allowing tax to be imposed on a nonresident trustee based solely on the in-state presence of a contingent trust beneficiary would be read as greatly expanding the power of states to tax nonresident corporations based solely on such corporations' relationships with various in-state entities, including but not limited to shareholders and other parties-in-interest.[12]

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[12] "There is considerable debate and uncertainty over whether, and the extent to which, federal constitutional restraints limit the States' power to impose income taxes on nonresident corporations with no or limited physical presence in the State, a point I simply note without pursuing the issue." Hellerstein, *Jurisdiction to Tax Income and Consumption in the New Economy: International, National, and Subnational Perspectives*, 38 Ga. L. Rev. 1, 47 fn. 149 (2003) (internal citation omitted). The College is concerned that a decision in favor of Petitioner could be used as a wedge by States to expand taxing power under the Due Process Clause based on resident shareholders' ownership of interests in non-resident, non-present corporations or similar entities.

III. THE TRUSTEE IN *HANSON* HAD FAR MORE CONTACTS WITH FLORIDA THAN THE KAESTNER TRUSTEE HAD WITH NORTH CAROLINA, YET FLORIDA LACKED PERSONAL JURISDICTION OVER THE TRUSTEE.

A. The Settlor-Beneficiary's Retention of Control Over Certain Aspects of the Trust's Operation Was Insufficient for Exercise of Personal Jurisdiction Over the Trustee in *Hanson*, Because the Trustee Did Not Purposely Avail Himself of Florida.

Enlarging State taxing jurisdiction over non-resident trustees based solely on presence of an in-state beneficiary would call into question the continued validity of *Hanson*, a case which the Court has repeatedly relied on in analyzing "minimum contacts" personal jurisdiction over non-residents.[13] The contacts between the non-resident trustee and the settlor-beneficiary in *Hanson* were far more extensive than those in the present case, but the Court determined those contacts to be insufficient under the Due Process Clause to exert Florida's State power over the nonresident trustee.

As this Court's jurisdiction-to-tax case law grows from the same roots that form the *in personam* and *in rem* jurisdictional framework described in *Hanson*, it would be unwise to create a variant jurisdictional test allowing North Carolina to exercise tax jurisdiction

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[13] See, e.g., *Walden v. Fiore*, 571 U.S. 277 (2014); *J. McIntyre Machinery, Ltd. v. Nicastro*, 564 U.S. 873 (2011); *Kulko v. Superior Court of Calif. In and For City and County of San Francisco*, 436 U.S. 84 (1978); *Shaffer v. Heitner*, 433 U.S. 186 (1977).

over a nonresident trustee. A close reading of *Hanson* illuminates the dangers to this Court's jurisprudence inherent in the relief sought by Petitioner. "The unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum State . . . [I]t is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." *Hanson* at 253.

The trust at issue in *Hanson* was created in 1935 by settlor Donner, then a domiciliary of Pennsylvania, by execution of a trust instrument in Delaware naming Wilmington Trust Co. of Delaware the trustee. After funding the trust with securities, the settlor moved to Florida in 1944 and remained there until her death in 1952. The trust reserved to the settlor all income from the trust corpus for her life, with the remainder to be paid to the settlor's selected trusts or persons based on her inter vivos or testamentary instrument. *Id.* at 238.

The trust instrument reserved to the settlor the authority to change the trustee and to amend, alter, or revoke the trust at any time. *Id.* at 238. However, Wilmington Trust Co. remained the trustee throughout the duration of the trust and at the point of the settlor's death. Thus, during the period of the settlor's life in Florida, the Delaware-based trustee maintained a relationship with the settlor in Florida, including making distributions to the settlor of the trust's income during her life.

This Court analyzed whether the Florida court had jurisdiction over the trust assets *in rem* and over the nonresident trustee *in personam*. It easily dispensed with whether a court may enter an *in rem* judgment

dealing with property outside the forum State. "Since a State is forbidden to enter a judgment attempting to bind a person over whom it has no jurisdiction, it has even less right to enter a judgment purporting to extinguish the interest of such a person in property over which the court has no jurisdiction. Therefore, so far as [the Florida judgment] purports to rest upon jurisdiction over the trust assets, [it] cannot be sustained." *Id.* at 250.

As to *in personam* jurisdiction, the Court recognized the evolution of its precedents from the "rigid rule" of *Pennoyer v. Neff*, 95 U.S. 714 (1878), to the "flexible standard" of *Int'l Shoe*. *Id.* at 251. Applying the flexible standard, the Court found that "the defendant trust company had no office in Florida, and transacts no business there. None of the trust assets has ever been held or administered in Florida, and the record discloses no solicitation of business in that State either in person or by mail." *Id.*

The acts of the settlor/beneficiary in executing the powers of appointment in Florida were insufficient to provide jurisdictional nexus to the nonresident trustees. "The unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum State." *Id.* at 253.

Of primary importance to the present case, appellant's argument that the domicile of "the settlor and most of the appointees and beneficiaries" in Florida gave the court personal jurisdiction over the nonresident trustees was deemed a "nonsequitur" because personal jurisdiction "is resolved in this case by considering the acts of the trustee" which were "insufficient to sustain the jurisdiction." *Id.* at 254. The Court reaffirmed that the restrictions of the Due Process

Clause "are more than a guarantee of immunity from inconvenient or distant litigation. They are a consequence of territorial limitations on the power of the respective States." *Id.* at 251. The trustee had no office in Florida and transacted no business there. None of the trust assets were held or administered in Florida, and there was no record of solicitation into Florida in person or by mail. No act was done or transaction consummated in the State giving rise to the underlying action. *Id.* The actions of the beneficiaries were of no consequence to the Court's analysis of jurisdiction over the trustee.

B. Ms. Kaestner's Contingent Interest Was Far More Limited Than That of the Settlor-Beneficiary in *Hanson* Due to the Legal Authority Granted to the Trustee and that She Was Only One of Several Potential Recipients of Distributions from the Trust.

"The person, property, or transaction" sought to be taxed by North Carolina is the income of the Kaestner Trust, not the income of the beneficiary. Therefore, the appropriate test is whether there is some "definite link, some minimum connection" between the Trust's income and the State of North Carolina, as a result of efforts by the trustee to "purposefully avail" the Trust of the protections of North Carolina. The presence in North Carolina of a contingent beneficiary of this nongrantor Trust cannot be a purposeful act of the trustee, since the trustee has no ability to control the acts of the beneficiary and does not select the beneficiary. Furthermore, neither the trustee nor the assets of the Trust have received any the benefits or protections of North Carolina.

There is only one trust instrument that controls the relationship between the trustee and the beneficiaries in this case: the Joseph Lee Rice, III Family 1992 Trust (referred to as the "Family Trust"). JA at 40 ¶ 9, 44-75. While Ms. Kaestner's portion of the Family Trust was divided into a "separate share trust" and named the "Kimberly Rice Kaestner 1992 Family Trust" (referred to by the parties as the "Kaestner Trust" or the "Trust"), it is administered under the terms of the Family Trust. Upon creation of the Family Trust and appointment of the trustee, the trustee took full title to the corpus of the trust.[14]

An examination of the material terms of the Family Trust shows that Ms. Kaestner was only one of several potential beneficiaries of the Trust. The trustee maintained legal power in his absolute discretion to control the Trust assets, to determine who received Trust distributions, and decide when those distributions would be made. While Ms. Kaestner and her children were primary beneficiaries,[15] the Third Article of the Trust established Joseph Lee Rice's spouse, his sister, and his sister's descendants all as contingent beneficiaries in the event the Trust assets were not fully distributed to the primary beneficiaries. JA at 52.

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[14] "When a settlor transfers property to another as trustee or declares a trust of that property, unless the transferor manifests a different intention, the trustee takes the settlor's full title or interest in that property." RESTATEMENT (THIRD) OF TRUSTS, § 2 (2003).

[15] While a "primary" beneficiary under the terms of the Trust instrument, Ms. Kaestner and her children were contingent beneficiaries of the Trust during the tax years at issue because they had no vested right to the current distribution of income from the Trust.

During all four tax years at issue, 2005-2008, the Trustee had "absolute discretion"[16] to make distributions of net income as he "may from time to time deem advisable." Trust Agmt. §1.2(a), JA at 47. He similarly had "absolute discretion" to make distributions of principal "as [he] . . . may from time to time determine." *Id.* at §1.2(b).

> If income of a trust is required to be distributed periodically, as annually, but distribution of the corpus is deferred, the gift of the income is one of a present interest . . . . A fortiori, if income is to be accumulated and paid over with the corpus at a later time, the entire gift is of a future interest, although upon specified contingency some portion or all of the fund may be paid over earlier. The contingency may be the exercise of the trustee's discretion, either absolute or contingent.

Fondren v. Comm'r of Internal Revenue, 324 U.S. 18 (1945).

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[16] A trustee with "absolute discretion" over whether to pay trust monies to a beneficiary cannot be required to pay over sums from the trust to creditors of the beneficiary. "No case is cited or known to the court which goes so far as to hold that an absolute discretion in trustees – a discretion which, by the express language of the will, they are under no obligation to exercise in favor of the bankrupt [beneficiary] – confers such an interest on the [bankrupt beneficiary] as can be successfully asserted in any court by him or his assignee in bankruptcy." *Nichols v. Eaton*, 91 U.S. 716, 717 (1875) (holding that creditors in bankruptcy could not claim any right to trust assets after the beneficiary's rights to receive trust distributions terminated under the terms of the trust instrument upon the insolvency of the beneficiary and that post-termination distributions made under the absolute discretion of the trustee could not be controlled by the beneficiary's assignee).

The trustee had the sole discretion to pay any of the potential Family Trust beneficiaries without making payments to any other beneficiary, and the trustee could exercise his discretion without regard to the assets already owned by any beneficiary. Trust Agmt. §1.4, JA at 50. The trustee further had the power to terminate the Trust at his discretion and to pay out the assets of the terminated Trust "in such amounts and proportions as the Trustee in the Trustee's absolute discretion may deem advisable." JA at 51-52. The gifts made by the settlor of the Trust to Ms. Kaestner and each of the other beneficiaries of the Trust was thus a future interest, not a present interest, which reinforces that there was no "present right of enjoyment" by Ms. Kaestner or the other beneficiaries. *See Fondren*, 324 U.S. at 502.

"[I]n addition to . . . those conferred by law," the trustee was invested with a broad range of powers and authority to manage the Trust assets, consisting of eighteen separate subsections within the Trust Agreement. Trust Agmt. § 5.2(a)-(r), JA at 55-60. Among the powers granted to the trustee was the power to "pay or contest any and all taxes assessed against any trust created hereunder" and to "do all such acts, take all such proceedings and exercise all such rights and privileges, although not herein specifically mentioned, with respect to any such property, as if the absolute owner thereof . . ." *Id.* at 5.2(q)-(r).

The Trust Agreement was made irrevocable and unamendable by the settlor, who declared that "[s]ubject to the Trustee's power to change the situs of the trust property of any trust hereunder, this Agreement and each trust hereunder shall be governed . . . according to the laws of the State of New York." JA at 69.

While the Trust Agreement contemplated that Ms. Kaestner and her children would be the recipients of distributions of the Trust's income and principal, nothing in the Trust instrument mandates such an outcome during the tax years at issue. The possibility that the income of the Trust might in the future be distributed to the beneficiary (such as Ms. Kaestner) does not create a current connection between the Trust's income and the State in which the beneficiary resides. If any distributions were made to Ms. Kaestner or her children while they were residents of North Carolina, the distributions of current year net income of the Trust would be subject to North Carolina income tax.

To the extent North Carolina imposes a throwback rule, prior year's trust income might also be taxable.[17] In an irrevocable nongrantor discretionary trust such as the one established by Ms. Kaestner's father, the trustee may make no distributions to a beneficiary for a span of many years, in the absolute discretion of the trustee. So long as the trustee's decisions are within the Trust's instructions and not an abuse of discretion, a primary beneficiary might never receive any distribution from the Trust, which instead may pass to other contingent beneficiaries.[18]

Contrast Ms. Kaestner's contingent expectancy interest as a beneficiary with that of the settlor-beneficiary in *Hanson*, who created her trust, funded

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[17] For a discussion of throwback rules, see footnote 25, *infra*, and the references cited therein.

[18] "Where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court except to prevent an abuse by the trustee of his discretion'" *Conkright v. Frommert*, 559 U.S. 506, 521–22 (2010) (quoting RESTATEMENT (SECOND) OF TRUSTS § 187 (1957)).

her trust corpus, reserved to herself the trust's income for life, and controlled the decisions of the trustee by means of the trust advisor and the ability to terminate the trust. Ms. Kaestner's contingent expectancy interest was minimal in comparison to that of Ms. Donner, further demonstrating the thinness of the jurisdictional reed upon which Petitioner's position is based. North Carolina should not receive taxes on income generated outside the State by a trustee residing outside the State using assets sitused outside the State solely because a potential future recipient of trust distributions happened to reside in the State during the tax years at issue.

The rationale for a State's right to tax income of its residents was explained by this Court in 1932: it is "founded upon the protection afforded to the recipient of the income by the state, in his person, on his right to receive the income, and in his enjoyment of it when received." *Lawrence v. State Tax Comm'n.*, 286 U.S. 276, 281 (1932).[19] Note that this description focuses on *receipt* of income, *right* to receive income, and the presumption that receipt of income allows *enjoyment* of that income. During the tax years at issue, none of these elements exists with respect to Ms. Kaestner: she did not receive any income generated by the assets in the trust, did not have any right to receive that income, and never enjoyed the benefit of the income. The underlying rationale of residence-based taxation

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[19] Taxation based on source of income, rather than residence of the income's recipient, is more circumscribed. The power derives from the protection that states provide to "persons, property, and business transactions within their borders." *Shaffer v. Carter*, 252 U.S. 37, 57 (1920). Since the income at issue was not derived from assets within North Carolina's borders, North Carolina cannot assert source-based taxation.

is not met under these facts, making it inequitable to impose the State's residence-based tax authority over income of the trust to which the resident beneficiary had no receipt, right, or enjoyment.

C. The Due Process Limits On The Extra-territorial Exercise of State Power Recognized In *Hanson* Counsel Against Extension Of North Carolina's Taxing Jurisdiction In This Case.

Petitioner attempts to distinguish *Hanson* by confining its jurisdictional analysis to adjudicative jurisdiction only. Pet. Br. at fn. 9. However, the jurisdictional reach of a State to impose a tax should be concomitant with the State's power to adjudicate disputes, since State taxing power must ultimately be exercised through adjudicative procedures in the taxing State.[20]

The North Carolina trust income tax is computed using the federal taxable income reported for the trust.[21] North Carolina law mandates that the trustee of the trust must file a trust income return and must pay the resulting tax computed. N.C. Gen. Stat. 105-160.2

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[20] It is doubtful that North Carolina's taxing power could be adjudicated in any forum other than North Carolina's state courts or this Court. *See, e.g., Fair Assessment in Real Estate Ass'n, Inc. v. McNary*, 454 U.S. 100 (1981); Tax Injunction Act, 28 U.S.C. § 1341 (1948); *Franchise Tax Bd. of Cal. v. Hyatt*, No. 17-1299 (U.S., filed March 12, 2018) (case submitted January 9, 2019 – decision pending).

[21] Line 1 on North Carolina's trust income tax form D-407 requires entry of "the federal taxable income from [IRS] Form 1041." N.C. Dept. of Rev. Form D407-A (Instructions for Form D-407).

and 105-160.5 (2017). The beneficiary plays no role in the filing of the return or the payment of the tax.

Taxation of a trust must be exercised against the trustee, as the trustee is the only person with the legal power to handle the trust assets and thereby pay the tax sums demanded by the State. Ms. Kaestner would have had no ability to pay the sum and no access to the information necessary to prepare the return.

Had the trustee not filed the return at all, or had the trustee filed the return but not paid the tax owed, any action taken by the North Carolina Department of Revenue to impose a liability upon the trust for unpaid income tax, or to collect upon such liability, would have required service upon the nonresident trustee and personal jurisdiction of the North Carolina courts over the trustee.[22] The same Due Process limitations which prevented Florida's chancery court in *Hanson* from exercising personal jurisdiction over a nonresident trustee – who had far more contacts with the Florida domiciled settlor-beneficiary of the trust than the contacts shown in the present case – prevent exercise of personal jurisdiction by North Carolina's courts to adjudicate any liability of the nonresident trustee for tax sums allegedly owed.

Adjudicative jurisdiction should not be separated from prescriptive or tax jurisdiction. Adopting Petitioner's argument would lead to a twisted branch of the Due Process Clause jurisprudence in which a State has power to tax a nonresident trustee solely based on the contacts imputed to him due to a resident

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[22] *See, e.g.*, N.C. Gen. Stat. § 105-243 (2017), authorizing the North Carolina Attorney General, upon request of the Secretary of Revenue, to commence an action in court to recover tax alleged to be due from a taxpayer.

contingent beneficiary, yet the same State would lack the power to bring the nonresident trustee before its courts to adjudicate and enter a binding judgment enforceable against that trustee regarding the tax liability of the trust.[23] *Quill* wisely relied on adjudicative jurisdiction case law (*Int'l Shoe*; *Burger King*; and *Shaffer*) in analyzing tax jurisdiction, since the power to tax should work hand-in-glove with the power of the courts to enforce the tax. If a State court cannot obtain personal jurisdiction over the "person, property, or transaction" to be taxed, the tax cannot be reduced to a judgment and enforced due to the absence of a necessary party. Thus, the power of the department of revenue to levy the tax should not exceed the authority of the State courts to enforce such tax where the person, property, or transaction sought to be taxed lacks the minimum contacts necessary for enforcement of the State tax law.

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[23] "Although it is conceivable that a natural or juridical person could be considered a resident for substantive jurisdiction-to-tax purposes but not for personal jurisdiction purposes or vice versa, the possibility seems sufficiently remote as to require no further discussion." Hellerstein, *Jurisdiction to Tax Income and Consumption in the New Economy: International, National, and Subnational Perspectives*, 38 Ga. L. Rev. 1, 9 fn. 23 (2003).

IV. CONNECTICUT'S TAX POLICY CHOICE DOES NOT EXPAND NORTH CAROLINA'S TAXING POWER BEYOND THE BOUNDARIES OF THE DUE PROCESS CLAUSE.

Petitioner argues strenuously that the result reached in the court below is unfair because of the possibility that a trust might avoid State income taxation depending on the State in which its trustee resides. Petitioner's discussion fails to acknowledge that every State maintains the power, consistent with the Due Process Clause, to tax the income of a trust within its taxing jurisdiction.

The Kaestner Trust could have been subject to income tax in the State of Connecticut but for the policy decision of that State to draft its trust income tax law to tax only "resident trusts" and to define a "resident trust" to mean a trust with a Connecticut settlor. Conn. Gen. Stat. § 12-701(a)(4)(C)-(D) (2013). Had Connecticut defined a resident trust to be one in which the trustee is a resident of the State, similar to at least fourteen other states,[24] the income of the Kaestner Trust would have been taxable there.

States retain expansive powers to impose taxes upon persons and property within their jurisdictional boundaries. In addition to their power to impose taxes on income generated by their residents and income generated by assets located in their borders, states may impose property taxes upon tangible and intangible property coming within their jurisdictional scope, including such assets held in trusts. States may

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[24] Arizona, Colorado, Hawaii, Indiana, Iowa, Kansas, Kentucky, Mississippi, Montana, New Mexico, New Jersey, Oregon, South Carolina, and Utah are states that tax trust income based on the presence of an in-state trustee or trust administration.

impose wealth taxes – measured by unrealized capital gains – if they are concerned that capital may be converted to income after the resident elects to move to an income-tax free jurisdiction. They may implement throwback tax provisions to capture accumulated prior years' income once a distribution is made to a trust beneficiary.[25]

Petitioner's hypothetical situation in which a trust beneficiary changes his or her permanent domicile to Florida prior to receiving a large distribution from a trust, and thereby is not taxed on the income resulting from that distribution, is not a "tax shelter." The policy choice by some states not to levy an individual income tax is part-and-parcel of our republican form of government in which each State is left to determine for itself the means and methods of taxation that best suit its needs. U.S. Const. art. IV, § 4, cl. 1.

Once a State makes its tax policy choices, a citizen may react accordingly, "arrang[ing] his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one's taxes. Over and over again the Courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible." *Gregory v. Helvering*, 69 F.2d 809, 810 (2d Cir. 1934), *aff'd*, 293 U.S. 465 (1935).

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[25] Pennsylvania, California, and New York have implemented throwback tax rules, which tax accumulated income received by a trust beneficiary in prior years, once the beneficiary receives a distribution that exceeds the distributable net income of the trust for the current year. *See* Amicus Brief for ACTEC at 15-19, describing the "throwback" tax regime.

The decision of a State such as Florida not to tax individual income, thereby creating an incentive for individuals receiving income to become domiciliaries of Florida, does not expand the jurisdictional reach of income-taxing states on the grounds that income might "escape taxation." There is no universal requirement that all income must be taxed by at least one State or that all capital must be taxed.[26] If taxpayers arrange their financial affairs in compliance with the tax policies each State adopts, and properly comply with those State tax systems, the fiscal impact on taxing authorities cannot be deemed unfair.[27]

As one example, a North Carolina resident may own stock of a corporation that increases in value. If the North Carolina resident lawfully changes his domicile to Florida before selling the stock, thereby avoiding North Carolina income tax on the now-realized capital gain in the stock value, the liberty of the taxpayer to arrange his affairs to avoid imposition of that tax is

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[26] Taxes might not be imposed upon a particular person, property, or transaction either because (1) a legislature has imposed a tax but then carved out an express exemption or exclusion prohibiting the tax from being applied to a particular situation, or (2) the State has chosen not to adopt a particular type or structure of tax. It is misleading and erroneous to label such non-tax situations as "tax avoidance" or "tax shelters" when they arise from the choices made by individual State legislatures.

[27] What would be unfair, and likely an irresolvable problem, is determining what percentage of a trust's income the State of a potential beneficiary may tax. If there is a class of potential beneficiaries, any of whom might ultimately receive a presently-undetermined future distribution of trust income, and those beneficiaries are present in multiple States, it would be essentially impossible – or wholly arbitrary – to fashion a workable apportionment methodology splitting the trust's income among the class of contingent beneficiaries spread across multiple States.

perfectly lawful. *See, e.g., Fowler v. N. C. Dept. of Revenue*, 775 S.E.2d 350 (N.C. App. 2015).

States desiring to avoid this situation can impose an annual property tax on intangibles[28] or a wealth tax measured by unrealized capital gain. What the State cannot do is reach undistributed income in the legal possession of a nonresident trustee having no contacts with the forum State based solely on one potential future beneficiary's presence in the forum State.

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[28] As least as far back as 1937, North Carolina's property tax law (known as the North Carolina Machinery Act) included annual *ad valorem* taxation of intangibles, including stocks and bonds. 1937 N.C. Sess. Laws, ch. 127, Article VIII, Schedule 8, § 700 (levying the tax); 1939 N.C. Sess. Law ch. 310, § 2(10) (defining "intangible property" to include "patents, copyrights, secret processes and formulae, good will, trademarks, trade brands, franchises, stocks, bonds, cash, bank deposits, notes, evidences of debt, bills and accounts receivable, and other like property.") This Court held in *Fulton Corp. v. Faulkner*, 516 U.S. 325, (1995) that North Carolina's intangibles tax on stock levied on a fraction of the value of corporate stock owned by State residents inversely proportional to the corporation's exposure to North Carolina income tax was discriminatory against interstate commerce in violation of the dormant Commerce Clause. The following year, the North Carolina legislature chose to exempt most forms of intangible personal property from ad valorem taxation. 1997 N. C. Sess. Laws ch. 23, § 1 (codified at N.C. Gen. Stat. § 105-275(31) (2017)).

CONCLUSION

For the foregoing reasons, the College respectfully submits that the decision of the Supreme Court of North Carolina should be affirmed.

Respectfully submitted,

C. WELLS HALL, III
Counsel of Record
CHARLES H. MERCER, JR.
REED J. HOLLANDER
NELSON MULLINS RILEY & SCARBOROUGH LLP
301 S. College Street
Suite 2300
Charlotte, NC 28202
(704) 417-3000
wells.hall@nelsonmullins.com

Counsel for Amicus Curiae

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No. 18-457

IN THE

Supreme Court of the United States

THE NORTH CAROLINA DEPARTMENT OF REVENUE,
Petitioner,

v.

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST,
Respondent.

ON WRIT OF CERTIORARI
TO THE SUPREME COURT OF NORTH CAROLINA

BRIEF AMICUS CURIAE FOR THE AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL IN SUPPORT OF NEITHER PARTY

Robert W. Goldman
Counsel of Record
Goldman Felcoski & Stone, P.A.
850 Park Shore Drive
Suite 203
Naples, Florida 34103
rgoldman@gfsestatelaw.com
239-436-1988
Counsel for Amicus Curiae

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STATEMENT OF INTEREST OF AMICUS CURIAE[1]

The American College of Trust & Estate Counsel ("ACTEC") is a nonprofit organization of more than 2,500 trust and estate lawyers and law professors from throughout the United States, Canada, Central and South America, Europe, and Asia. Fellows of ACTEC are skilled and experienced in trust and estate law and are elected by their peers on the basis of their professional reputation, quality of their work, and their substantial pro bono contributions to the practice and the public, including lecturing, writing, teaching, and drafting court rules and legislation. ACTEC is dedicated to enhancing trust and estate law and practice through research, education, technical advice to governments, and, on rare occasions, offering assistance to courts in understanding this area of the law.

Established in Los Angeles in 1949, ACTEC's office is now located in Washington D.C. and is governed by 39 Fellows who serve on its Board of Regents, six of whom are the officers of ACTEC. Much of the work done by ACTEC is performed by committees, including the Amicus Review Committee.

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[1] Counsel for the parties were not in any way involved in authoring this brief. Neither counsel for a party nor a party made a monetary contribution to fund the preparation or submission of this brief. No other monetary contributions were made.

The Amicus Review Committee[2] and the officers of ACTEC voted unanimously to approve ACTEC's filing of an amicus brief in this case.[3]

In this case, we believe we can assist the Court in understanding the history and practice of state fiduciary income taxation as applied to undistributed income of trusts and the complexities of such statutes in the context of the multi-state contacts common in today's mobile society.

SUMMARY OF ARGUMENT

Petitioner frames the question before the Court as "Does the Due Process Clause prohibit states from taxing trusts based on trust beneficiaries' in-state residency?" Respondent frames the question this way: Did the North Carolina Supreme Court correctly apply settled due process

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[2] The Amicus Review Committee consists of Margaret G. Lodise, Sacks, Glazier, Franklin & Lodise LLP, Los Angeles, California (chair), Robert W. Goldman, Goldman Felcoski & Stone, P.A., Naples, Florida; Carlyn S. McCaffrey (Past President of ACTEC), McDermott Will & Emery LLP, New York, New York; Professor Robert H. Sitkoff, Harvard Law School, Cambridge, Massachusetts; Bruce M. Stone (Past President of ACTEC), Goldman Felcoski & Stone, P.A., Coral Gables, Florida; and Gregory N. Barrick, Durham, Jones & Pinegar, Salt Lake City, Utah (State Chair, Utah).

[3] The brief was drafted by an ad hoc committee consisting of David A. Berek, Jonathan G. Blattmachr, Jane G. Ditelberg, Gregory Gadarian, Mitchell M. Gans, Carl L. King, Richard W. Nenno, Raj A. Malviya, and Charles A. Redd.

principles to the unique facts of this case when the State sought to tax the worldwide income of a trust to which it had no connection, based solely on the domicile of a discretionary beneficiary who might never in fact become entitled to receive a distribution from this trust? In order to assist the Court in its consideration of due process under the circumstances of this case, ACTEC's brief discusses the nature of trusts, the income taxation of trustees under federal and state laws, and due process jurisprudence that may have an impact on the income taxation of trustees.

ARGUMENT

I. INTRODUCTION

The goal of ACTEC is to assist the Court in understanding the nature of irrevocable trusts and the relationship between the Due Process Clause and state fiduciary income tax laws.

Our discussion is limited to the income taxation of trustees of trusts that are subject to taxation under the general rules of Subchapter J of Chapter 1 of the Internal Revenue Code of 1986, as amended ("I.R.C.).[4]

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[4] Trusts that are subject to tax under Subchapter J of Chapter 1 of the IRC are defined in Treas. Reg. §301.7701-4 as arrangements created by "will or by inter vivos declaration whereby trustees take title to property for the purpose of protecting it or conserving it for the beneficiaries under the

II. OVERVIEW OF TRUSTS AND FIDUCIARY INCOME TAXATION

A trust is a legal arrangement created by a person (the settlor, grantor, trustor, or testator) who transfers property to another person (the trustee) to hold and administer for the benefit of another person or persons (the beneficiary or beneficiaries). The hallmark characteristic of a common law trust is the division of legal and equitable title to trust assets: "the trustee holds legal title to the trust property, but the beneficiaries have equitable or beneficial ownership." Robert H. Sitkoff & Jesse Dukeminier, WILLS, TRUSTS AND ESTATES, 10th Ed. (2017). This Court recognized this duality and its application in determining the due process implications of state taxation of trusts in *Greenough v. Tax Assessors*, 331 U.S. 486, 494 (1947). *See also Americold Realty Tr. v. Conagra Foods Inc.*, 136 S. Ct. 1012 (2016) (focusing on the citizenship of the trustee, not the beneficiaries, for diversity-of-citizenship purposes after acknowledging that a trust is not a separate entity but a fiduciary relationship). Thus, fiduciary

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ordinary rule applied in chancery or probate courts." Other arrangements that may be referred to as "trusts," such as business trusts, are not subject to the rules of Subchapter J. Instead, they are taxed as associations, corporations, or partnerships. Subchapter J treats the income of certain trusts as owned by the trust's grantor or, in some cases, by its beneficiary. The trustees of those trusts do not pay federal tax on trust income. These trusts are generally referred to as "grantor trusts". Trusts that are not subject to the grantor trust rules are referred to as "nongrantor trusts". Most states, but not all, follow the federal rules and will not subject the trustees of grantor trusts to state income tax.

income tax (the tax imposed on income earned from trust assets but not distributed to and taxed to a beneficiary) is imposed on a trustee, and not on the trust itself, which is not a separate entity or taxpayer. That a trust may be acknowledged as having a separate existence for income tax purposes only, *Anderson v. Wilson*, 289 U.S. 20, 27 (1933) ("[T]he law has seen fit to deal with this abstraction [i.e., a trust] for income tax purposes as a separate existence"), does not diminish the fact that a trust, as such, cannot sue or be sued or take or be impacted by any action. A trust acts and is acted upon only by and through its trustee.

A. State Taxation of Trustees

States that impose a fiduciary income tax generally impose their tax on trustees of trusts that have certain defined connections to the state. Most states refer to these trusts as "resident trusts."[5] States define the relevant connections for a resident trust in several different ways. These differences lead to inconsistent state fiduciary income tax treatment of the same trustees and can result in the same income being subject to state income tax two or more times. Some states, recognizing the constitutional limits on their ability to tax, do not

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[5] Additionally, many states impose a fiduciary income tax on trustees of trusts that do not meet that residence test but have income generated within that state, commonly known as "source income." The taxation by a state of trust income sourced in that state is not the subject of this proceeding.

tax trustees of resident trusts in certain circumstances.[6]

B. Trustee Taxation and Constitutional Limitations

One of the first reported decisions of this Court to test the constitutionality of a state's taxation of trustees was *Safe Deposit & Tr. Co. v. Virginia*, 280 U.S. 83 (1929). The *Safe Deposit* case involved a state intangibles tax assessed by Virginia against a Maryland trustee. The Court held that the imposition of an intangibles tax by Virginia was unconstitutional under the Due Process Clause because the actual situs of the property was in Maryland where the trustee, the holder of legal title to the trust property, was located, and neither the grantor nor the beneficiaries who resided in Virginia had control over the trust estate.

As discussed below, the states that impose fiduciary income taxes have made various choices in selecting the basis for taxation of trustees. While North Carolina has sought to impose a tax based

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[6] New York State, for example, will not tax the trustees of a resident trust if the trust has no trustees who are domiciled in New York, no New York source income, and no physical property located in New York. N.Y. Tax Law §605(B)(3)(D). *See also* Richard Nenno, *Bases of State Income Taxation of Nongrantor Trusts, State Survey*, American College of Trust and Estate Counsel (ACTEC), updated February 25, 2019, https://www.actec.org/assets/1/6/Nenno_state_nongrantor_tax_survey.pdf, *passim*, for a summary of the state fiduciary income tax statues. (Nenno, *State Survey*).

upon the residence of a beneficiary within the state, the legislature could have selected any number of other grounds for taxation which might not have been constitutionally problematic.[7]

C. Shared Beneficial Interests

In addition to the bifurcation of the ownership of trust property between legal and equitable interests (held respectively by the trustee and the beneficiaries), the trust itself can provide a variety of benefits for one or more different beneficiaries. These interests can be consecutive (current and future beneficiaries) or concurrent (multiple current beneficiaries). In addition, beneficiaries can be designated as contingent recipients of an interest in trust property, meaning their right to receive property is not vested, and non-contingent recipients of trust property, meaning the beneficiary has a vested interest in receiving trust property (though such a right can be subject to divestment upon the happening of a contingency, if the terms of the governing instrument so provide).

A trustee may have an obligation to distribute all income earned by trust assets to a particular beneficiary or group of beneficiaries, an obligation to distribute all income but discretion over who among

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[7] Choosing another basis for imposing a fiduciary income tax might not have resulted in tax paid by the trustee of the Kaestner Trust but the state could have generated income tax from trustees of other trusts that did meet the alternate residency test.

the group of permissible beneficiaries receives it, or complete discretion over whether, when and to whom to distribute trust income. A beneficiary's interest in a trust may be contingent upon an exercise of discretion by a trustee, or contingent upon the happening of an event such as reaching a specific age or the beneficiary's survival until the termination of someone else's beneficial interest in the trust. For example, a trust instrument may provide for distributions of income to a beneficiary only in the discretion of the trustee until the beneficiary reaches age 21, and mandatory distribution of all income to the beneficiary after age 21. For purposes of this discussion, we will consider a beneficiary who is entitled by the terms of the trust to receive all or a portion of the income generated by trust assets in a particular year as having a "vested" interest. All other beneficiaries have contingent income interests until the necessary condition has been satisfied and will be referred to as having contingent interests.

A trust may have a single beneficiary who is a current permissible recipient of trust income or to whom income must be distributed. Many trusts have multiple beneficiaries who, at any particular time, are permissible recipients of trust income in the discretion of the trustee. These contingent beneficiaries may be adults or minors, and may live in one state or in many states. Each may be receiving significant distributions from a trust or may never receive any distribution from the trust, depending on the trust terms and the needs and other resources of that beneficiary as well as

anticipated needs of future contingent beneficiaries. Some trusts provide time periods where no distribution may be made to any beneficiary.[8]

D. Contingent Beneficiaries and the Conduit Nature of Fiduciary Income Taxation

It is possible that a contingent beneficiary may never receive a distribution of trust property. A contingent beneficiary possesses no current ownership rights in the trust property, and the property is not vested in the beneficiary.

The federal model of fiduciary income taxation provides that income is taxed only once: either to the beneficiary or to the trustee. In broad terms, income earned from trust assets is generally taxable to the beneficiary if the income is distributed or if the beneficiary has the unrestricted right to demand distribution. The income is otherwise taxable to the trustee. Thus, unless the beneficiary has such an unrestricted right, undistributed income is taxable to the trustee. I.R.C. §§ 651-652 and 661-662.

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[8] For an extreme example, *see* Barry, *Mr. Thullusson's Will*, 22 VA. L. REV. 416 (1935-36), describing Peter Thellusson's Will, which directed at his death in 1797 that all income must be accumulated until all of his sons and grandsons living at his death were deceased, which was a period of about sixty years.

III. STATE APPROACHES TO TAXATION OF TRUSTEES

A. No Income Taxation

Currently, seven states—Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming—do not have a state income tax. Additionally, New Hampshire generally does not tax the income of trustees of nongrantor trusts[9] resident in its state

B. Criteria for Income Taxation of Trustees of Resident Trusts

Each of the other states and the District of Columbia taxes trustees of trusts resident in its jurisdiction. A trust can become a resident trust in one or more particular states under one or more of the following criteria:[10] (1) if the trust was created by the Will of a testator who was domiciled in the state

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[9] Unless otherwise specified, all references to "trust" mean a nongrantor trust, as discussed earlier in this brief at Section I, footnote 4.

[10] A few states also view a statement of governing law in the trust agreement as a factor in determining trust residency. For example, Louisiana taxes a trust if the trust specifically provides that Louisiana law governs, but it does not tax such a trust if the trust specifies that the law of another state applies. *See* Louisiana Fiduciary Income Tax Return and Instructions, form IT-541 at 4. However, Idaho and North Dakota consider the designation of their laws as only one factor in determining whether a trust is a resident trust. *See* Nenno, *State Survey*.

at death; (2) if the settlor of an inter vivos trust was domiciled in the state when the trust became irrevocable; (3) if the trust is administered in the state; (4) if one or more trustees live or do business in the state; or (5) if one or more beneficiaries are resident in the state.

C. The North Carolina Approach

The approach adopted by North Carolina is uncommon. A total of only four states (North Carolina, Tennessee, Georgia, and California) impose a tax on trustees of trusts based on the residence of a beneficiary in the state. In addition, of those four, only two, North Carolina and Tennessee, do so based upon the residence of contingent beneficiaries.[11] The North Carolina Supreme Court held that the North Carolina statute as applied to the trustees of the Kaestner Trust violates the Due Process Clause. There is no published decision in Tennessee on this issue.

Where a trust has sufficient contacts with a state, the state may tax the trustee on undistributed

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[11] *See* Cal. Rev. & Tax. Code §§ 17041(a)(1), 17043(a), 17742(a). In Georgia, this result is reached by analogy to. Ga. Comp. R. & Regs. 560-7-8- .35(1)(d.), which does not characterize a trust with Georgia beneficiaries but a non-resident trustee as a resident trust and does not require such a trustee to withhold tax upon the sale of real estate in such trusts. In Tennessee, the entire income tax is being phased out and will be fully repealed as of January 1, 2021. *See* Tenn. Dept. Revenue, *2018 Guidance for Tennessee's Hall Income Tax Return*, July 12, 2017.

income. The question in this case is whether the trustees of a trust having no contacts with North Carolina other than the residence of its contingent beneficiaries, may be subject to tax in North Carolina on undistributed income that is not sourced within the state and which may or may not ever be distributed to a North Carolina resident. North Carolina's tax regime attempts to tax undistributed trust income which a large majority of the other states do not tax. Of course, North Carolina is free to tax such income as it chooses as long as its tax regime complies with the requirements of the Due Process Clause.

IV. THE SAME TRUST COULD BE A RESIDENT OF SEVERAL STATES OR OF NO STATE

There is no universal rule among the states that a trust is allowed to be a resident of only one particular state. Consequently, depending on the circumstances, a trust could easily satisfy one or more of the residency criteria of multiple states where the settlor, trustee, beneficiary, and assets have a nexus. This overlapping effect creates the problem of trusts that are treated as resident trusts in more than one state and thus the trustees of such trusts are potentially subject to multiple state income tax levies without an offsetting tax credit or other mechanism to allay the impact of double taxation. Although this Court has held that state taxation by multiple jurisdictions is federally constitutional in the transfer tax context, *see, e.g., Curry v. McCanless*, 307 U.S. 357, 368–71 (1939), it

has not addressed state residency-based income taxation by multiple jurisdictions.

In 2015, the Multistate Tax Commission, a United States intergovernmental state tax agency created by the Multistate Tax Compact of 1967, took up an inquiry concerning the problems created by the patchwork of state fiduciary income tax regimes. The Commission made a key observation about a proposed uniform fiduciary income tax statute:

> Due to increasing state interest in attracting financial institutions, the group decided to eliminate any factor from the residency test related to trustees or trust administration. The project therefore would involve determining which remaining factors best reflect a trust's presence in the state; whether multiple factors or a hierarchy would be involved [.]"[12]

In this case, petitioner points to the fact that the Kaestner Trust may avoid state income taxation altogether because it is not a resident trust in any state. While this may be true in a particular year, this is not because there are no states with a nexus sufficient to impose a tax on the trustee of the Kaestner Trust if such a state elected to adopt a

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[12] Lila Disque, *Interstate Taxation of Trusts: The Multistate Tax Commission Project.*, address and materials in connection with the American Bar Association Section of Real Property, Trust and Estate Law Spring Symposia, State Income Taxation of Trusts Holding Business Interests (Apr. 30, 2015) (project ultimately abandoned when states could not reach consensus concerning approach to taxation).

different tax regime. Further, if the income accumulated and not subject to North Carolina tax in one year is distributed to a North Carolina resident in a later year, North Carolina could, as outlined below, impose its tax then when it has become clear that the resident beneficiary has in fact received previously accumulated income.

States typically impose tax on a beneficiary in the year in which the beneficiary receives the income from the trust. The mechanism for this taxation involves granting the trust a deduction for the payment and requiring the beneficiary to include the income in his or her tax return in the same year. In this case, because no distribution was made to the beneficiary, this mechanism did not apply. As a result, North Carolina would not ever be able to tax the accumulated income when it was distributed unless it changed its statute to tax the distribution of accumulated income in the year of receipt by a beneficiary.

North Carolina has chosen not to use this approach. Instead, North Carolina attempts to impose an income tax directly on the trustee in the year in which the income is earned on the sole basis that the trust's contingent beneficiary resided in North Carolina. The facts in this case demonstrate why this approach may not satisfy the minimum connection requirement of the Due Process Clause. No distributions were ever made to Ms. Kaestner while she was a resident of North Carolina, and indeed might never be made to a person who resided in North Carolina at the time of a distribution. If

income is accumulated in the discretion of the trustee while Ms. Kaestner lives in North Carolina but is never distributed to her and is ultimately distributed to a resident of another state in a future year, North Carolina's only connection with that income will have been the possibility that it might have been, but was not, distributed to a North Carolina resident.

Petitioner argues that "[b]eneficiaries[13] like Ms. Kaestner can now accumulate income in their trusts over several decades, avoid taxes on that income, and then, before taking a distribution from their trusts, simply move—even temporarily—to a state like Florida that does not assess income taxes. Nothing would stop these beneficiaries from returning the following year to their home state to resume residency after taking tax-free distributions from their trusts." Petition for Writ of Certiorari dated October 9, 2018 at 21. We note that the same problem arises if residents of North Carolina purchase publicly traded stock that appreciates while the owners reside in North Carolina but who, before selling the stock, simply move to Florida.

Other states have sought to address this problem, in part, through the imposition of a tax on the distribution of a trust's accumulated income.

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[13] It is a trustee, and not a beneficiary, that makes decisions about distributing or accumulating income. We assume petitioner is using this term as short-hand for a beneficiary not requesting a distribution or objecting to the accumulation of income by the trustee.

This type of tax is commonly referred to as a "throwback tax." In some cases, federal income tax law imposes a tax on the distribution of accumulated income in order to prevent the tax savings that could result from temporary accumulations of income of a trust that paid income taxes at lower rates than its beneficiaries and the tax savings that could result for the beneficiaries of foreign trusts that pay no federal tax on accumulated income. I.R.C. §§665-668. The tax is computed essentially by "throwing" the accumulated income back to the tax years of the beneficiary that roughly correspond to the years when the income was earned by the trust. The beneficiary receives a credit for the federal income tax paid by the trustee in those years. Although the throwback tax formerly applied to both foreign and domestic trusts, because the income tax rates for trustees have been sufficiently compressed to eliminate the opportunities for this type of perceived abuse in the case of domestic trusts, the throwback rules have been limited in application generally only to foreign trusts and domestic trusts that used to be foreign. *See, generally*, General Explanation of the Tax Reform Act of 1986 (H.R. 3838, 99th Congress; Public Law 99-514), prepared by the Staff of the Joint Committee on Taxation (May 4, 1987), 1243-1246

Any state could adopt similar throwback rules. Pennsylvania,[14] California,[15] and New York have done so.[16] Under such a throwback regime, the beneficiary who actually receives and benefits from the accumulated income would be taxed on it. For example, if a trustee accumulates income in 2019 while a contingent beneficiary lives in California, California does not tax it in that year. However, if a distribution is made to the California beneficiary in 2020 that includes income accumulated in 2019, California imposes its tax in 2020.[17]

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[14] Pennsylvania assesses a throwback tax on accumulation distributions to resident beneficiaries from nonresident trusts. 61 Pa. Code § 105.5(c).

[15] The California throwback rule provides that a beneficiary who currently receives income that was not previously taxed in California because the beneficiary had a contingent interest at the time it was accumulated is subject to tax on the distribution when it is distributed to him or her. CA. Rev. & Tax Code § 17745(b) provides that "if no taxes have been paid on the current or accumulated income of the trust because the resident beneficiary's interest in the trust was contingent, such income shall be taxable to the beneficiary when distributed or distributable to him or her."

[16] The New York throwback rule was enacted to address situations involving nongrantor trusts which qualify for an exception from New York income tax applicable to certain New York resident trusts and that accumulate income which is distributed to New York resident beneficiaries in subsequent years. N.Y. Tax Law § 612(b)(40).

[17] California Franchise Tax Board, Form 541, Schedule J.

The federal throwback rules generally require the recipient of a distribution of accumulated trust income to be taxed essentially as if that income had been received when it was earned by the trust. Adjustments for the time value of money, that is to say interest on the tax deferred until the accumulated income is distributed, can eliminate the financial advantages to the beneficiary of the deferral of the tax. *See* I.R.C. §668 (imposing a non-deductible interest charge on the throwback tax imposed on accumulated distributions from foreign trusts).

The fact that a beneficiary who anticipates receiving accumulated income might escape state taxation of this income by changing his or her state of residence before the receipt of the accumulated income, creates no different a problem than the possibility that individual taxpayers may avoid state taxation by changing residency before any other type of income is received. For example, a shareholder who anticipates receiving a substantial dividend next year on stock he or she currently owns can change residency before the dividend is received by moving to a state with no (or a lower) income tax on dividends. The result should be no different for trust distributions of accumulated trust income.

Moreover, the hypothetical posited by petitioner – a North Carolina resident beneficiary moves to another state to receive the distribution and then moves back to North Carolina – is easily addressed through the application of conventional anti-abuse tax doctrines. For example, the move to

the other state could be ignored for tax purposes on the ground it is not a bona fide change in residence.

V. CONSTITUTIONAL CHALLENGES TO STATE INCOME TAXATION OF TRUSTEES

As noted above, the states and the District of Columbia apply one or more criteria to determine whether a trust is a resident trust. If a trust is a resident trust, the state's tax regime generally subjects the trustee of the trust to tax in that state on its worldwide income, regardless of where the income is derived. While it may be obvious in some situations whether a particular state's residency statute applies because of the location of a trustee or sufficient trust administration contacts within the state, other situations may be more challenging to analyze because the state connections have evaporated, shifted, are weak, or are even nonexistent.

In the situations where valid contacts within a state exist, the state may tax the trustee of a trust only if doing so will not violate the state's Constitution and the U.S. Constitution. The rulings of this Court and the decisions of various state and federal courts on the state income taxation of trustees or the application of other state tax statutes have focused on two constitutional restraints on a state's right to impose a tax—the Due Process Clause of the Fourteenth Amendment and the

Commerce Clause. U.S. Const. Amend. XIV, § 1 and U.S. Const. Art. I, § 8, Cl. 3.[18] Given the issues posed in this case, we limit our discussion to the application of due process principles to the taxation of trustees on their undistributed income.

A. Due Process Clause

The Fourteenth Amendment to the U.S. Constitution provides that no state shall "deprive any person of life, liberty, or property, without due process of law." U.S. Const. Amend XIV, § 1. The North Carolina Constitution guarantees due process rights by providing that no person shall be "in any manner deprived of his life, liberty, or property, but by the law of the land." Article I, Section 19 of the Constitution of North Carolina. The North Carolina

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[18] The Commerce Clause gives Congress the sole power to regulate commerce among the states. U.S. Const. Art. 1, §8, cl. 3. In *Kaestner*, the North Carolina Supreme Court only examined the Due Process Clause argument. The court below did not reach the more rigorous Commerce Clause analysis, because it was able to strike down the North Carolina fiduciary income tax statute under the Due Process Clause. As a result, this issue was abandoned by respondent on appeal. In *Complete Auto Transit v. Brady*, this Court articulated a four-part test to determine if a state tax violates the Commerce Clause: (1) Nexus: there must be a sufficient connection between the taxpayer and the state to warrant the imposition of state tax authority; (2) Fairly Apportioned: the state must not tax more than its fair share of the income of a taxpayer; (3) Non-Discrimination: the state must not treat out-of-state taxpayers differently from in-state taxpayers; and (4) Fairly Related to Services: the tax must be fairly related to services the state provides to its taxpayers. *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977).

Supreme Court has noted that "[t]he term 'law of the land' as used in Article I, Section 19, of the Constitution of North Carolina, is synonymous with 'due process of law' as used in the Fourteenth Amendment to the Federal Constitution." *Rhyne v. K-Mart Corp.*, 358 N.C. 160, 180 (2004). Accordingly, the *Kaestner* Court analyzed the State and Federal due process challenges together.

This Court's decision in *Quill Corp. v. North Dakota* is consistently cited in Due Process Clause challenges to state tax statutes. *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992), overruled in part by *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2099 (2018).

According to *Quill*, when a state seeks to impose a tax, the Due Process Clause requires: (1) "some definite link, some minimum connection, between a state and a person, property or transaction it seeks to tax;" and (2) "that the income attributed to the State for tax purposes . . . be rationally related to values connected with the taxing state." *Id.* When analyzing the first requirement, courts consider whether a taxpayer's "connections with a State are substantial enough to legitimize the State's exercise of power over" it. *Id.* at 312. It is important that, when the taxpayer has no physical presence in a state, the taxpayer must "purposefully avail itself of the benefits of an economic market in the forum state." *Id.* at 307. This requirement ensures that the taxpayer is given "fair warning that its activity may subject it to the jurisdiction of a foreign sovereign." *Id.* at 308. The

courts then analyze the second component and assess "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state." *Id.*

The *Kaestner* Court carefully analyzed the first component of the Due Process Clause under the *Quill* lens."[19] In *Quill*, this Court held that the Due Process Clause's "minimum contacts" test no longer required physical presence in a state to permit state taxation. *Quill Corp.*, 504 U.S. at 318–19. Shortly before this Court's decision in *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2099 (2018), the *Kaestner* Court applied the *Quill* analysis of due process principles and still found that the trustee of the Kaestner Trust did not have the minimum contacts with North Carolina necessary to cause the trustee to be subject to tax.

B. Post *Quill* Decisions Addressing Due Process

Since *Quill* was decided, a handful of state courts have issued published decisions on the constitutionality of state taxation of trustees. Only

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[19] It also applied recent precedent in North Carolina standing for the proposition that "a finding of minimum contacts to satisfy due process will vary with the quality and nature of the [party's] activity, but it is essential in each case that there be some act by which the [party] purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws. *Skinner v. Preferred Credit*, 361 N.C. 114, 123; 638 S.E.2d 203, 210-11 (2006).

two of those decisions, *Dist. of Columbia v. Chase Manhattan Bank*, 689 A.2d 539 (D.C. App.. 1997) and *Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999), upheld the state taxation regime in question on due process grounds. However, in both of those outlier cases, all but one of the trusts at issue were testamentary trusts created under the Will of a resident decedent, thus involving the necessity of the state's probate laws to effectuate the trust. One of the trusts involved in the Connecticut case was an inter vivos trust with one current beneficiary who had significant rights over the trust including the right to receive all trust property at age 45 and the right to direct how the property would be disposed of if she had died before age 45. It is not clear that the court would have reached the same conclusion if the beneficiary's rights were less substantial.

The majority of the decisions, including *Kaestner*, struck down the challenged tax statute as unconstitutional, with the exception of one decision, in which the court held in favor of the taxpayer based on other grounds. *Residuary Tr. A U/W/O Kassner v. Dir. Div. of Taxation*, 28 N.J. Tax 541 (Super. Ct. App. Div. 2015), *aff'g*, 27 N.J. Tax 68 (N.J. Tax Ct. 2013); *Linn v. Dep't of Revenue*, 2 N.E.3d 1203 (Ill. App. Ct. 2013); *McNeil v. Pennsylvania*, 67 A.3d 185 (Pa. Comlth. Ct. 2013); *Kimberley Rice Kaestner 1992 Family Tr. v. N.C. Dep't of Revenue*, 814 S.E.2d 43 (N.C. 2018), *aff'g*, 789 S.E.2d 645 (N.C. Ct. App. 2016), *aff'g*, No. 12 CVS 8740, 2015 WL 1880607 (N.C. Sup. Ct. Apr. 23, 2015); *Fielding v. Comm'r of Revenue*, 916 N.W.2d 323 (Minn. 2018),); *Bank of America, N.A. v. Comm'r*

of Revenue, 54 N.E. 3d 13 (Mass. 2016).

C. *Wayfair*

Only weeks after the *Kaestner* decision, this Court issued its opinion in *Wayfair*, overturning in part its ruling in *Quill*, which had stood as precedent since 1992. In a 5-4 decision, this Court declared that the physical presence requirement of the Commerce Clause, established under the substantial presence prong of the *Complete Auto* Test. was "unsound and incorrect," and that *Quill* and its 1967 predecessor decision, *National Bellas Hess Inc. v. Illinois*, were overruled.

The *Wayfair* decision should have no impact on the *Kaestner* decision. The *Wayfair* decision's rejection of the physical presence test applied to the Commerce Clause, not the Due Process Clause. The *Kaestner* Court, which based its decision on the Due Process Clause, did not rely on the lack of physical presence of the trust or of the trustee in North Carolina because the physical presence test as applied to the Due Process Clause had already been rejected by this Court in the *Quill* case. Although *Quill* rejected the Due Process physical presence test, it still required "'some definite link, some minimum connection, between a state and the person, property or transaction is seeks to tax,' *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-345 (1945), and that the 'income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State." *Moorman Mfg. Co. v. Blair*, 437 U.S. 267, 273 (1978)" *Quill Corp.*, 504

U.S. at 306. The *Kaestner* Court held that the residency of the beneficiary was insufficient to establish the required minimum connection.

A trust is not a business entity, but, as discussed in Section I, is a relationship between a trustee and beneficiaries involving the legal and beneficial ownership of property. Thus, it is difficult to determine where, if anywhere, a trust can be said to have the minimum connection Due Process requires, although, clearly, the residence of the trustees, the beneficiaries, the settlor/testator, or the location of trust assets are all possibilities. The *Kaestner* Court focused on the independent significance of a trust and rationalized how a third party's (a beneficiary's) physical contacts within the state cannot be attributed to the taxpayer (the trustee of the trust) to determine tax residency.

A trustee holds legal title to trust assets. A contingent or discretionary beneficiary generally has no property rights whatsoever until the contingency terminates or trust assets are distributed to him or her. In *Brooke v. City of Norfolk*, this Court considered whether the City of Norfolk and Commonwealth of Virginia had violated the Due Process Clause by taxing the trustee of a Maryland trust when none of the property held in the trust had ever been present in Virginia. Although this Court applied a presence-focused due process analysis that has since been supplanted, this Court also did not attribute the residency of the beneficiary to the trustee, and observed that the property held by the Maryland trustee "was not within the State, does not

belong to the [beneficiary] and is not within her possession or control. The assessment is a bare proposition to make the [beneficiary] pay upon an interest to which she is a stranger," *Brooke*, 277 U.S. at 29. Similarly, in *Mercantile-Safe Deposit & Tr. Co. v. Murphy*, the New York Court of Appeals held that the Due Process Clause prohibited New York from taxing the accumulated income of an inter vivos trust, funded in part during life and in part by a pour-over of assets under the decedent's Will, that had no New York trustee, New York assets, or New York source income, even though the current discretionary beneficiary was a New York resident. *Mercantile-Safe Deposit & Tr. Co. v. Murphy*, 203 N.E.2d 490 (N.Y. 1964), aff'g, 242 N.Y.S.2d 26 (App. Div. 1963).

The parties affected in *Wayfair* were contracting parties each consenting to a sales transaction. This type of contractual relationship is very different from one of a trustee and beneficiary, where the beneficiaries of a discretionary trust normally have no say or control over distributions made by the trustee or the decisions of the trustee regarding the location of trust assets or the trustee's domicile.[20]

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[20] *See In re: Naarden Trust*, 990 P.2d 1085 (Ariz. 1999) (a trust is not a contract); RESTATEMENT (SECOND) OF TRUSTS, Section 169 comment c ("Although the trustee by accepting the office of trustee subjects himself to the duties of administration, his duties are not contractual in nature").

D. The Most Recent Trust Nexus Case: *Fielding v. Commissioner of Revenue*

Less than a month after the *Wayfair* decision, the Minnesota Supreme Court in *Fielding v. Commissioner of Revenue* held that the trustees of four trusts created by a Minnesota domiciliary with a current Minnesota beneficiary, but administered by a non-resident trustee, lacked minimum contacts and could not be subject to state income tax under the Due Process Clause. The court concluded:

> [E]ven when the additional contacts the Commissioner cites are considered in combination, the State lacks sufficient contacts with the Trusts to support taxation of the Trusts' entire income as residents consistent with due process. The State cannot fairly ask the Trusts to pay taxes as resident in return for the existence of Minnesota law and the physical storage of trust documents in Minnesota. Attributing all income, regardless of source, to Minnesota for tax purposes would not bear a rational relationship with the limited benefits received by the Trusts from Minnesota during the tax year at issue. We therefore hold that Minn. Stat. § 290.01, subd.7b (a)(2), is unconstitutional as applied to the Trusts.

Fielding v. Commissioner of Revenue, 916 N.W.2d 323 (Minn. 2018), *aff'g*, 2017 WL 2484593 (Minn. Tax Ct. May 31, 2017), petition to the U.S. Supreme Court for writ of

certiorari filed Nov.15, 2018.

Fielding found the application of the Minnesota tax regime violated the Due Process Clause.[21] Because of this, the *Fielding* Court did not need to address Commerce Clause arguments. *Fielding*, 916 N.W.2d at 334 n.11.

VI. WITHOUT MINIMUM CONTACTS THERE IS NO JURISDICTION OVER THE TRUSTEE

A critical component of the due process analysis involves an evaluation of personal or *in rem* jurisdiction. The Due Process Clause does not permit a state to exercise personal jurisdiction over an individual or corporation with which the state has no contacts, ties, or relations. *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

In considering whether a particular state has jurisdiction to tax, it is important to remember that a trust is a relationship, not an entity. The trust does not pay tax; the trustee does, and it should not be assumed that a state has jurisdiction to tax a nonresident trustee. This Court articulated this very concept in 2016:

> Traditionally, a trust was not considered a distinct legal entity, but a "fiduciary

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[21] On November 15, 2018, the Minnesota Department of Revenue filed a petition for certiorari with this Court.

> relationship" between multiple people. Such a relationship was not a thing that could be haled into court; legal proceedings involving a trust were brought by or against the trustees in their own name. And when a trustee files a lawsuit or is sued in her own name, her citizenship is all that matters for diversity purposes. For a traditional trust, therefore, there is no need to determine its membership, as would be true if the trust, as an entity, were sued.
>
> *Americold Realty Tr. v. Conagra Foods, Inc.*, 136 S. Ct. 1012, 1016 (2016) (citations omitted). *See also Raymond Loubier Irrevocable Tr. v. Loubier*, 858 F.3d 719, 722 (2d Cir. 2017) ("[I]t is the trustees' citizenship, not that of beneficiaries, that matters for purposes of diversity"); *Yueh-Lan Wang v. New Mighty U.S. Tr.*, 843 F.3d 487, 487 (D.C. Cir. 2016) ("a so-called 'traditional trust' carries the citizenship of its trustees").

This Court addressed the limits of personal jurisdiction in 2017, in *Bristol-Myers Squibb Co. v. Superior Court of California*. There, Justice Alito described the limits on the California courts' exercise of personal jurisdiction:

> It has long been established that the Fourteenth Amendment limits the personal jurisdiction of state courts. Because a state court's assertion of jurisdiction exposes defendants to the State's coercive power, it is

subject to review for compatibility with the Fourteenth Amendment's Due Process Clause, which limits the power of a state court to render a valid personal judgment against a nonresident defendant. The primary focus of our personal jurisdiction inquiry is the defendant's relationship to the forum State.

* * *

Since our seminal decision in International Shoe, our decisions have recognized two types of personal jurisdiction: "general" (sometimes called "all-purpose") jurisdiction and "specific" (sometimes called "case-linked") jurisdiction. For an individual, the paradigm forum for the exercise of general jurisdiction is the individual's domicile; for a corporation, it is an equivalent place, one in which the corporation is fairly regarded as at home. A court with general jurisdiction may hear any claim against that defendant, even if all the incidents underlying the claim occurred in a different State. But only a limited set of affiliations with a forum will render a defendant amenable to general jurisdiction in that State.

Specific jurisdiction is very different. In order for a state court to exercise specific jurisdiction, the suit must arise out of or relate to the defendant's contacts with the forum. In other words, there must be an affiliation between the forum and the

> underlying controversy, principally, an activity or an occurrence that takes place in the forum State and is therefore subject to the State's regulation. For this reason, specific jurisdiction is confined to adjudication of issues deriving from, or connected with, the very controversy that establishes jurisdiction. *Bristol-Myers Squibb Co. v. Superior Ct. of California*, 137 S. Ct. 1773, 1779, 1780-81 (2017).

This Court concluded that the connection between the nonresident's claims and the forum was too weak and thus, the California courts lacked specific personal jurisdiction. *Bristol-Myers*, 137 S. Ct. at 1782.

The 2013 decision of a federal district court in Pennsylvania in *Bernstein v. Stiller* dealt with a comparable issue. There, trust beneficiaries sought accountings and removal of the trustees in Pennsylvania and contended that the trustees' filing of a state income-tax return declaring the trust to be a Resident Trust gave the court jurisdiction. Judge Surrick held:

> The declared residency of the trust assets is insufficient to give the Court personal jurisdiction over Respondent Trustees.

Bernstein v. Stiller, 2013 WL 3305219, at *1 and 7 (E.D. Pa. June 27, 2013).

A court will have personal jurisdiction over a foreign trustee in certain situations, such as when it appointed the trustee. *See Ohlheiser v. Shepherd*, 228 N.E.2d 210, 215 (Ill. App. Ct. 1967). *Ohlheiser v. Shepherd* involved a Wisconsin resident who was appointed as successor trustee of an Illinois testamentary trust. There the trustee argued "a nonresident defendant must have certain minimum contacts with the forum state before jurisdiction in personam can be obtained by service of process outside the state." The court disagreed, stating "we consider that defendant, as successor trustee of a testamentary trust, became an officer of the court appointing him when he accepted the appointment by entering upon his duties as successor trustee. Although these duties did not require him to perform any act while physically within the State of Illinois, he impliedly submitted himself to the in personam jurisdiction of the court of appointment until discharged from his office."

VII. APPLYING THESE PRINCIPLES TO STATE FIDUCIARY INCOME TAX CASES

In *Quill,* the Court indicated that, under the Due Process Clause, a state may only impose a tax if "some minimum connection" or "definite link" exists between the state and the "person, property or transaction it seeks to tax." *Id.* at 306 (quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344–345 (1954)). The *Quill* Court, in determining the due process requirements applicable in assessing the validity of a state tax, went on to apply the personal-jurisdiction contours it has deduced from

International Shoe Co.: an inquiry that focuses on whether the "defendant had minimum contacts with the jurisdiction." 504 U.S. at 307-8.

In *Hanson v. Denckla*, 357 U.S. 235, 253–254 (1958), the Court concluded that Florida courts did not have personal jurisdiction over a Delaware trustee of a trust even though its beneficiaries resided in Florida. *Id.* at 254 (it would be a nonsequitur to conclude that the Florida courts "should be able to exercise personal jurisdiction over the nonresident trustees" on the ground that "most of the appointees and beneficiaries were domiciled in Florida"). The Court has repeatedly reaffirmed *Hanson*. *See, e.g., Bristol-Myers Squibb*; *Walden v. Fiore*, 571 U.S. 277, 284 (2014).

To the extent that due process limitations on personal jurisdiction and taxation are to remain consistent, a decision that expands the scope of a state's taxing power should concomitantly expand the jurisdictional reach of courts over out-of-state defendants. Thus, should the Court decide that due process permits a state in which beneficiaries reside to tax a trust being administered by a trustee in another state based solely on the fact of the beneficiary's residence, it should reconsider *Hanson*. Likewise, should the Court decide to adhere to the principle adopted in *Hanson* – that a state in which the beneficiary resides does not have personal jurisdiction over an out-of-state trustee – it should reject the petitioner's argument that the presence of beneficiaries in North Carolina permits it to tax the undistributed income of out-of-state trustees.

Petitioner argues that *Safe Deposit & Trust Co.* – holding that due process does not permit the state of the beneficiary's residence to tax the income of a trust being administered by an out-of-state trustee – should be overruled. Indeed, if it is not overruled, the petitioner's argument is foreclosed. To be sure, *Safe Deposit* does predate *International Shoe* and, to the extent of any inconsistency, it should be reconsidered. But *Safe Deposit* does not appear to be inconsistent with the *International Shoe* framework. In *Hanson*, applying the framework, the Court concluded that the residency of the beneficiary was an insufficient contact for jurisdictional purposes, thus suggesting that *Safe Deposit's* analogous conclusion in the tax context is not only consistent with the framework but compelled by it. In short, should the Court decide to reconsider *Safe Deposit*, a similar reexamination of *Hanson* would be in order.[22]

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[22] Another line of authority implicated by a decision to make the beneficiary's residence determinative relates to the application of diversity-of-citizenship jurisdiction in the context of trusts. The Court has held that, where a trust is a party, the citizenship of the trustee, not the beneficiary, is controlling for diversity purposes – treating the trust as a relationship between trustee and beneficiary and not as a separate entity. *Americold Realty Tr. v. Conagra Foods, Inc.*, 136 S.Ct. 1012 (2016) (traditionally, trust "not considered a distinct legal entity, but rather a 'fiduciary relationship' between multiple people"). If the Court adheres to this concept of a trust as a relationship, it would seem that the contacts of a beneficiary with a state should not be imputed to the trust – no more than the contacts of one contracting party should be imputed to other contracting parties. Thus, should the Court decide to

Taxing the trustee based on the contacts of the beneficiary with the taxing state appears to be at odds with the thrust of the *International Shoe* framework. The inquiry under the framework is whether the taxed party (or the transaction) or the defendant in the jurisdictional context has the requisite contact with the state asserting its taxing power or its jurisdiction. Imputing the contacts of the beneficiary to the trustee would entail a different inquiry. Thus, should the Court decide to adopt a principle that imputes the beneficiary's contacts to the trustee, it may want to explicitly adjust the focus of the *International Shoe* framework. Further, an analysis that seeks to tax the trustee based on the beneficiary's residence should take into account the speculative nature of the connection between the trust's income and its beneficiary. As suggested, in the overwhelming majority of cases, the beneficiary does not have a vested right to the trust's accumulated income and may indeed never become entitled to receive it – thus raising the question whether it is appropriate to make relevant the residence of such a beneficiary. *See Brooke v. City of Norfolk* at 28 (impermissible to make the beneficiary pay tax on property "not within her possession or control").

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impute the contacts of the beneficiary to the trustee for purposes of state taxation, it may want to reconsider the treatment of trusts for diversity purposes.

CONCLUSION

The American College of Trust and Estate Counsel is grateful for the opportunity to bring these issues to the attention of the Court.

Respectfully submitted,

Robert W. Goldman
Counsel of Record
Goldman Felcoski & Stone, P.A.
850 Park Shore Drive
Suite 203
Naples, Florida 34103
rgoldman@gfsestatelaw.com
239-436-1988
Counsel for Amicus Curiae

No. 18-457

In The Supreme Court of the United States

NORTH CAROLINA
DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST,

Respondent.

On Writ Of Certiorari To The Supreme Court Of North Carolina

BRIEF OF AMICA CURIAE PROFESSOR ROBERTA LEA BRILMAYER IN SUPPORT OF RESPONDENT

WILLIAM D. ZABEL
Counsel of Record
CATHERINE GREVERS SCHMIDT
JOHN J. RECTOR
SCHULTE ROTH & ZABEL LLP
919 Third Avenue
New York, New York 10022
212-756-2000
william.zabel@srz.com
catherine.schmidt@srz.com

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

QUESTION PRESENTED

Under the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution, may a state impose its tax on a trust whose only connection with the taxing state is the relocation to that state, subsequent to the formation of the trust, of one of the trust beneficiaries?

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INTEREST OF AMICA CURIAE[1]

Lea Brilmayer is the Howard M. Holtzmann Professor of International Law at Yale Law School, where she teaches and writes on Conflict of Laws.

In addition to her more than thirty years on the Yale Law School faculty, she has taught at the Columbia Law School, the University of Texas Law School, the University of Chicago Law School, Harvard Law School, and New York University Law School. She has written a number of books and literally dozens of articles on Conflict of Laws, both interstate and international, with a particular focus on personal jurisdiction and choice of law. Among the briefs that she has authored or coauthored are several briefs amica curiae to this Court. *See, e.g.*, Brief for Lea Brilmayer as Amica Curiae Supporting Petitioner, *Daimler AG v. Bauman*, 571 U.S. 117 (2013) (No. 11-965), 2013 WL 3377320; Brief for American Association of University Professors, *Connolly v. Burt*, 475 U.S. 1063 (1986) (No. 85-298) (brief submitted prior to case being mooted); Brief for Columbia University, Harvard University, Stanford University, and the University of Pennsylvania as Amici Curiae, *Regents of Univ. of Cal. v. Bakke*, 438 U.S. 265 (1978) (No. 78-811), 1977 WL 188007, *40. She currently serves as a Member of the Advisory Board to the Draft

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[1] No counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than amica curiae, its members, or its counsel made a monetary contribution to its preparation or submission. The parties have filed blanket consents.

Restatement (Third) of Conflict of Laws and previously served as a member of the Advisory Board to the 1986 Revisions to the Restatement (Second) of Conflict of Laws. She submits this brief in the hope it will help the Court in resolving the question presented.

Professor Brilmayer's professional affiliation is listed for purposes of personal identification, and is not intended as suggesting any approval or adoption of the views expressed below by Yale University or Yale Law School.

SUMMARY OF ARGUMENT

This case involves the State of North Carolina's efforts to tax the Kimberly Rice Kaestner 1992 Family Trust (the "Kaestner Family Trust" or the "Trust," as applicable), a non-resident trust which never distributed trust income or principal within North Carolina, never invested or held assets in North Carolina, was never administered by any trustee residing in North Carolina, and never conducted any other sort of business in North Carolina during the relevant time period. *Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Dep't of Revenue*, 814 S.E.2d 43, 44-45 (N.C. 2018). At the time that it was established, the Trust had no connections at all with North Carolina and the only connection that the Trust *ever* developed with North Carolina *at any time* was the relocation to North Carolina, well after the Trust was established, of one Trust beneficiary.

North Carolina's treatment of the Kaestner Family Trust fails to satisfy the Due Process Clause of the Fourteenth Amendment for three reasons: (1) insufficient contacts for adjudicative jurisdiction; (2) insufficient contacts for jurisdiction to impose its tax law; and (3) insufficient contacts to satisfy due process limitations of choice of law. What few connections North Carolina has to the Trust are all with one of the Trust's beneficiaries, rather than with the trustees. In order to cure this defect, North Carolina argues that the connections that it has with one beneficiary can substitute for the traditional elements of jurisdiction over the trustee.

The North Carolina Department of Revenue's efforts to tax the Kaestner Family Trust on the basis of the after-acquired domicile of a single beneficiary sets North Carolina's taxation laws on a collision course with the Due Process Clause of the Fourteenth Amendment of the U.S. Constitution. Standard due process jurisprudence leads to the following conclusions:

(1) States may assert adjudicative jurisdiction over non-resident parties whose conduct has effects in the state, who assert a right to property located in the state, or who are so closely tied to the state as to be effectively "at home" there. As a matter of undisputed fact, however, none of these paradigmatic jurisdictional bases exists in the present case with regard to the trustees;

(2) In the absence of meaningful connection between the property in question, the

party taxed, and the taxing state, jurisdiction to tax does not exist; and,

(3) Even if North Carolina law clearly and consistently supported the position that jurisdiction should be measured by the extent of the beneficiary's contacts—which it does not—there is no basis for North Carolina to have taken the position it urges the Court to adopt, namely that it is the beneficiary's contact that counts. As a matter of settled federal constitutional due process limitations, New York law applies to the question of whether the beneficiary's role in the Trust is so important that despite her formal irrelevance to the minimum contacts analysis, her contacts nonetheless be treated as dispositive for jurisdictional purposes. The instruments creating the Trust specified application of New York law and the mere coincidence of her after-acquired domicile in North Carolina is insufficient as a matter of constitutional law to override the fact that at the time that the Trust instrument was drafted, all connections pointed towards New York. It would violate the Fourteenth Amendment for North Carolina's courts to disregard this obvious truth.

For these reasons, the judgment below of the North Carolina Supreme Court should be affirmed.

ARGUMENT

I. Examination of the underpinnings of the Due Process Clause's theories of adjudicative jurisdiction and jurisdiction to tax reveals that the Due Process Clause does not support North Carolina's effort to tax the Kaestner Family Trust.

No state may exercise its adjudicative authority or apply its law unless it has a basis for doing so consistent with the Fourteenth Amendment Due Process Clause. *See Quill Corp. v. North Dakota*, 504 U.S. 298, 306-07 (1992) (jurisdiction to tax); *International Shoe Co. v. Washington*, 326 U.S. 310, 319 (1945) (jurisdiction to adjudicate). The due process standards in these two contexts are thoroughly intertwined. *See Quill*, 504 U.S. at 306-09 (applying updated personal jurisdiction jurisprudence to jurisdiction to tax analysis); *see also id.* at 319 (Scalia, J., concurring) ("[A]bandonment of *Bellas Hess*' due process holding is compelled by reasoning 'comparable' to that contained in our post-1967 cases dealing with state jurisdiction to adjudicate."). Fourteenth Amendment Due Process Clause precedents involving challenges to assertions of state court jurisdiction and Fourteenth Amendment Due Process Clause precedents involving challenges to tax are cited almost interchangeably; the two bodies of authority are mingled in the case law. *See, e.g., South Dakota v. Wayfair Inc.*, 138 S. Ct. 2080, 2093 (2018) (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985)); *Quill*, 504 U.S. at 308 (citing *Shaffer v. Heitner*, 433 U.S. 186, 218 (1977)).

Table 1 below depicts the different possible bases for adjudicative jurisdiction and jurisdiction to tax that bear on the validity of North Carolina's tax assessment. Adjudicative jurisdiction and jurisdiction to tax (Column 1 on the left and Column 2 on the right, respectively) each support three theories: jurisdiction based on effects within the state of conduct taking place elsewhere (the top row, Row A); jurisdiction based on the existence of property within the state (the middle row, Row B); and jurisdiction based on the insider status of the defendant (the bottom row, Row C).[2]

Table 1	
Due Process Bases for Adjudicative Jurisdiction	**Due Process Bases for Jurisdiction to Tax**
Adjudicative Jurisdiction Based on Effects	**Jurisdiction to Tax Based on Effects**
Principle: The Due Process Clause generally allows the forum's courts to assert jurisdiction over defendants whose conduct	***Principle:*** The Due Process Clause generally allows the taxing state to impose financial disincentives on out of state

[2] There are other bases as well, but these have little relevance to the present problem. For example, express consent is an adequate basis for adjudicative jurisdiction. In addition, entrance into the forum to engage in actionable conduct could possibly be treated as separate from effects-based jurisdiction in which the defendant never entered the forum. This would alter the number of different types of jurisdiction (because "effects" jurisdiction would be split into two) but would not cause any substantive analytical changes.

has effects within the forum state for matters related to that conduct. The Due Process Clause requires "purposeful availment" of the benefits of forum law on the part of the defendant and the conduct having effects in the forum must be the defendant's own conduct. ***Justification:*** the state's interest in protecting persons and property within its borders by shifting to the defendant the cost of the inconvenient litigation. ***Examples:*** "stream of commerce" cases; "nonresident motorist" statutes	taxpayers in order to deter behavior having negative effects in the taxing state. ***Justification:*** the state's interest in protecting persons and property within its borders through the imposition of taxes/financial penalties. ***Examples:*** excise taxes on cigarettes sold in the state.
Property Ownership ***Principle:*** The Due Process Clause allows a state to assert jurisdiction over a defendant who owns property in the state on matters related to that property. ***Justification:*** the state's interest in determining or regulating ownership of assets located within it.	**Property Ownership** ***Principle:*** The Due Process Clause allows a state to tax property held within the state even when it is owned by an out of state taxpayer. ***Justification:*** the state's interest in recouping some or all of the costs created by property held within it.

Examples: quiet title actions; "slip and fall" cases (suit against owner for failure to maintain property which caused the plaintiff's injury).	***Examples:*** real estate taxes, personal property taxes or use taxes; inheritance taxes.
At Home ***Principle:*** The Due Process Clause allows a state to assert jurisdiction over defendants who are effectively "at home" in that state over any and all matters. ***Justification:*** citizens of a state submit to their state's sovereignty by participating in its democracy and should provide one guaranteed forum where an individual is indisputably subject to suit on any cause of action. ***Examples:*** jurisdiction over residents, domiciliaries, locally incorporated legal entities; defendants whose contacts with the forum state are sufficiently systemic and continuous.	**Raising Revenue** ***Principle:*** The Due Process Clause allows states to impose taxes to raise "general" revenue by taxing the citizens of that state or to raise financial support for provision of services, including to non-locals. ***Justification:*** absent collection of taxes, the people of a state will be unable to support social and economic programs, provide police protections, etc., or to charge for the provision of particular services. ***Examples:*** tax on local person's income, special purpose taxes (e.g., sewage districts).

A. The theory of "effects jurisdiction" justifies neither North Carolina's assertion of adjudicative jurisdiction nor North Carolina's assertion of jurisdiction to tax.

Row A in Column 1 and Column 2 depicts adjudicative jurisdiction based on effects and tax jurisdiction based on effects, respectively. "Effects jurisdiction" in the adjudicative jurisdiction context (Column 1) refers to situations in which the forum asserts its judicial authority over litigation arising when a dispute with some sort of multistate aspect (e.g., conduct that took place elsewhere or that was caused by outsiders) causes harm in the forum. *See Calder v. Jones*, 465 U.S. 783, 787 (1984). This category includes, for example, what has become known as "stream of commerce" jurisdiction. *See J. McIntyre Mach., Ltd. v. Nicastro*, 564 U.S. 873, 881 (2011); *Asahi Metal Indus. Co. v. Superior Ct.*, 480 U.S. 102, 112 (1987). The theoretical foundation of this type of jurisdiction is obvious: it is the state's ability to protect persons and property within its borders. Adjudicative effects jurisdiction supports the state's policy interest in deterring and/or compensating legally actionable conduct taking place across state lines, by making it possible to bring those causing the harm to justice.

In keeping with this rationale, the Due Process Clause requires intentionality of some sort, such as foreseeability or purposeful availment. *See World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 297-98 (1980) (requiring foreseeability); *Hanson v. Denckla*,

357 U.S. 235, 253 (1958) (requiring purposeful availment). Since the object is to discourage further occurrences in the future, there is little point in penalizing the causation of harms that could not be foreseen or prevented.

Column 2 depicts effects jurisdiction in the specific context of taxation. There is considerable overlap between this category and effects-based adjudicative jurisdiction. Like the theory of effects-based adjudicative jurisdiction, effects based tax jurisdiction is frequently used to change behavior or to direct it into what is seen as socially more desirable directions. For example, states frequently place excise taxes on cigarettes in order to minimize what were perceived to be undesirable health consequences. *See, e.g.*, N.C. Gen. Stat. § 105-113.2 et seq. (2019) (taxing cigarettes and other tobacco products).

The due process requirements on jurisdiction to impose taxes of this sort are very similar to the limitations on adjudicative jurisdiction. The Due Process Clause requires taxing states to establish both that the taxpayer has minimum contacts with the taxing state, *see Quill*, 504 U.S. at 306 (citing *Miller Bros. Co. v. Maryland*, 374 U.S. 340, 344-45 (1954)), and that the particular tax is rationally related to advancing the states' legitimate interest in deterring the in-state effect, *see id.* (citing *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978)).

It might seem at first that North Carolina's claim to impose its taxing authority on the Trust would be

based on a theory of effects jurisdiction. In the present case, one might argue that North Carolina's tax was imposed to deter actions that had effects in North Carolina. Someone or something from outside the state was directed into the state and the result was an event in North Carolina that North Carolina had a right to regulate.

In the present context, however, neither jurisdiction to adjudicate nor jurisdiction to tax can be predicated upon an analysis of effects.[3] The reason is that the party who caused the in-state effects—the relocation of one beneficiary to North Carolina—is not the party over whom jurisdiction is sought. It is jurisdiction over the trustee that is sought, while the decision to move to North Carolina was made by the beneficiary. This basis for jurisdiction cannot justify the assertion of either adjudicative or tax jurisdiction because if it influences anything, it influences the wrong party's behavior. Moreover, assertion of jurisdiction cannot be justified in terms of effects when imposing a duty to defend simply penalizes innocent conduct, such as the trustee's performance of official trust duties as to which no allegations of wrongfulness have been made (e.g., the trustee's performing his required duty of providing the beneficiary with an accounting of the Trust assets, *Kimberly Rice Kaestner 1992 Family*

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[3] In addition to the factual problems described here in the text, it is highly implausible that North Carolina imposed the tax to deter Trust beneficiaries from moving to North Carolina. There is no clear reason that the state would want to do that, and it has not claimed such a motive.

Trust v. North Carolina Dep't of Revenue, 814 S.E.2d 43, 45, 50-51 (N.C. 2018). *See, e.g.*, *Kulko v. Superior Court*, 436 U.S. 84, 96-97 (1978) (Jurisdiction can be based on effects in the forum only where it is alleged that defendant engaged in wrongful conduct causing injury in the forum, not where the defendant merely acquiesced in his daughter's request to be allowed to live with her mother.).

B. Jurisdiction based on property cannot justify the tax because the Trust holds no property in North Carolina.

In theory, the location of the property can form an adequate basis for jurisdiction to adjudicate or jurisdiction to tax. But as with jurisdiction based on effects, the theory of jurisdiction based on property fails to provide jurisdiction on the facts of the case at hand.

The Due Process Clause permits both adjudicative and tax jurisdiction over nonresident's property held in the forum state. *See, e.g.*, *Shaffer v. Heitner*, 433 U.S. 186 (1977) (discussing the history of property as a basis for jurisdiction). Frequently the asset in question is real property, but the reasoning extends to other sorts of property as well. Jurisdiction based on property is depicted in Row B of Table 1. Since the landmark holding in *Shaffer* the property must be related to the dispute. *Id.* at 213.

The theoretical basis for this type of jurisdiction is obvious. Every state has a legitimate right to determine the ownership of assets that are located within

it. *Id.* at 207-08. Furthermore, it is perfectly compatible with "traditional notions of fair play and substantial justice" to require the claimants to cooperate with this state interest, from which they derive substantial benefits. *International Shoe Co.*, 326 U.S. at 316. Property located in the forum may impose costs, bring about harms, or generate controversy there. *See Shaffer*, 433 U.S. at 199-200 (discussing the traditional category of in rem jurisdiction). States are entitled to expect that nonresident claimants will help in defraying those costs.

It would, moreover, be inconsistent for an individual both to claim ownership of property within the state but also deny the existence of minimum contacts. Accordingly, there is a due process basis for the state imposing its taxes on outsiders who own property, or claim to own property, within the state. *See Miller Bros. Co.*, 347 U.S. at 345.

If the Kaestner Family Trust owned property in North Carolina, North Carolina could tax that property or income sourced from it. In fact North Carolina does so for trusts so situated. *See* N.C. Gen. Stat. § 105-160.2 (2017). But North Carolina does not now claim that there is property in North Carolina that could justify jurisdiction over the trustee. The facts of the case at hand therefore do not support using property to base jurisdiction to tax.

C. "At-home" jurisdiction does not exist in the present case with regard to either jurisdiction to adjudicate or jurisdiction to tax.

A final category of potential justifications for the application of state power, depicted in Row C of Table 1, involves an individual's direct relationship with a particular state with which he or she has very significant connections. *See Goodyear Dunlop Tires Operations, S.A. v. Brown*, 564 U.S. 915 (2011). Historically, this was the type of jurisdiction that a state had over a person who was domiciled or resident in, incorporated in, or otherwise substantially associated with the forum. *See id.* at 924; Brilmayer et al., *A General Look at General Jurisdiction*, 66 Tex. L. Rev. 721, 728 (1988). Through clarification by this Court, this type of jurisdiction has become known as "at-home" jurisdiction, because in order for jurisdiction to exist the defendant must have his or her "home" in the forum. *See Daimler AG*, 571 U.S. at 122, 127; *Goodyear*, 564 U.S. at 924.[4]

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[4] With the "general jurisdiction" that typically accompanies such bases for the exercise of state authority, all substantive claims are equally supported by the contacts that the plaintiff alleges to exist between the defendant and the forum. Since it is the defendant's direct relationship with the forum that justifies jurisdiction, and not the defendant's relationship as mediated through a particular controversy, the existence of jurisdiction is independent of the content of the cause of action. A finding of at-home jurisdiction therefore supports power to entertain all claims against the defendant. *See Goodyear*, 564 U.S. at 919; *Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 415-16 (1984).

The theory of at-home jurisdiction rests on principles of democratic sovereignty; it is all a matter of self-governance. It is fair to require the defendant to appear and defend in local courts when those local courts are the courts of the defendant's own political community.[5] At-home jurisdiction is a general concept, which justifies all manner of exercise of state power over the forum political community. In the context of jurisdiction to tax, however, special considerations apply. The most common justification for taxes, of course, is the legitimate interest in raising revenue; states are expected to be able to support social, economic, educational, and political projects financially. Ilya Somin, *Revitalizing Consent*, 23 Harv. J.L. & Pub. Pol'y 753, 759 (2000). However, while it is surely a legitimate interest on the part of the state to use the tax system to raise money, this interest is not, by itself, adequate to satisfy due process. It goes at most halfway to point out that the state has a legitimate interest in raising money; the state must in addition justify imposing the tax on the particular taxpayers who are commanded to pay. *See Walden v. Fiore*, 571 U.S. 277, 283-86 (2014) (summarizing the Court's case law on this issue); *see also Quill*, 504 U.S. at 306 (The state must justify its imposition of a tax on a particular taxpayer.). From a due

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[5] Thirteen years after the Trust was formed, a successor trustee, domiciled in Connecticut, was appointed. *Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Dep't of Revenue*, No. 12-CVS-8740, 2015 WL 1880607, at *1 (N.C. Super. Ct. Apr. 23, 2015). This might make the Trust at home in Connecticut instead of New York, but because it makes no difference to North Carolina's ability to assert general jurisdiction over the Trust, this is not examined further.

process perspective, it is as important that the state raise money from the right people as that it raise money at all. Surely Kansas could not justify taxing the people of Ohio to support Kansas' social programs simply by saying that Kansas really needed money.

The question whether it is a suitable group that is being asked to provide financial support rarely presents a problem when the taxpayer is at home in the state.[6] If a citizen asks, "why me?" a legitimate answer is, "because you are a member of a political group that has decided to pursue particular objectives and to undertake particular programs—along with your fellow citizens, you have undertaken to impose these burdens on yourselves." This is why a state has extremely broad tax powers over those who are at home in it. *See Comptroller of Treasury of Md. v. Wynne*, 135 S. Ct. 1787, 1798 (2015) ("The Due Process Clause allows a State to tax '*all* the income of its residents, even income earned outside the taxing jurisdiction.'")

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[6] There has always been dispute over precisely how much connection was required to establish this relationship of citizenship or near-citizenship. Being domiciled or a citizen of a state would be sufficient under traditional standards, as would being incorporated in the state for corporations. *Goodyear Dunlop Tires Operations, S.A.*, 564 U.S. at 924; Brilmayer et al., *A General Look at General Jurisdiction*, 66 Tex. L. Rev. 721, 728 (1988). However, other characteristics could also potentially suffice to render a person at home in a state. For example, the fact that a trust has its principle place of administration in the state, or was originally set up in the state and is governed by its trust laws, would contribute to its being "at home" in the state. Under such logic, the Kaestner Family Trust would seem to be at home in New York or Connecticut, but not North Carolina.

(quoting *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 462-63 (1995)). And so it might seem that at-home jurisdiction is available whenever the individuals whose interests are at stake are local people.

This argument appears to lend support to the claim that at-home jurisdiction is available in the case at hand. In the present case there was, after all, at least one potential stakeholder who was at home in North Carolina: the Trust beneficiary. Can minimum contacts with the forum be shown by the North Carolina domicile of the beneficiary? Can the after-acquired domicile of the beneficiary substitute for contacts between the forum and the trustee? North Carolina's claim to at-home jurisdiction over the Trust seems at first to have more potential than either an effects-based or a property-based theory. It can be argued that the at-home theory justifies jurisdiction because the beneficiary was "at home" in North Carolina.

There are, however, serious problems with this claim. As the discussion above indicates, jurisdiction does not exist where imposition of the burden to defend would influence the conduct, at most, of the wrong people. It is true that if the nonresident trustee had the same quantity and quality of contact with North Carolina as the beneficiary does, then jurisdiction over the trustee would exist. This does not mean, however, that the contacts between the beneficiary and the forum can be transferred to the trustee, and used to obtain jurisdiction over him; nor does it mean that contacts with the trustee are unnecessary. North Carolina's chief problem in the case at hand is precisely

that the wrong individual has connections to the forum. North Carolina has established contacts with an individual who is not a party to the dispute, who is not the individual named in its caption, and who is not the one that will be expected to pay the judgment. This does nothing to protect the due process rights of the individual who actually would be required to pay. Under the at-home theory, no less than other theories discussed here, the focus must still be on contacts between the forum and the trustee. This problem turns out to be insurmountable for North Carolina's establishment of jurisdiction.

II. North Carolina cannot base jurisdiction over the trustee on the North Carolina domicile of the beneficiary.

In the case at hand, North Carolina's problem lies in the fact that it wants to substitute the contacts of the beneficiary for the contacts of the trustee. This Court explained the reasons for not allowing such a substitution in the landmark case of *Hanson v. Denckla*, 357 U.S. 235 (1958). In *Hanson*, the strategy of simply shifting focus to individuals more amenable to jurisdiction was rejected.

A. The forum may not manipulate the party structure of the dispute solely in order to refocus the jurisdictional inquiry upon individuals more likely to be amenable to jurisdiction.

Like the present case, *Hanson*, 357 U.S. 235, involved litigation over a trust, and the ties between the forum and the involved individuals all took the form of connections between the forum and the beneficiaries. There were no ties between the forum and the trustee. *Id.* at 238-43. The plaintiff sought to proceed without the participation of the trustee; but this Court recognized that under Florida law, it was the trustee who was the necessary party. *Id.* at 245. Since it would have violated due process to assert jurisdiction over the trustees, the case had to be dismissed. *Id.* at 244. In *Hanson*, this Court refused to allow the forum to simply substitute another defendant who was more amenable to jurisdiction.

As with the present case, in *Hanson* there were adequate ties for jurisdiction over the beneficiary—had jurisdiction over the beneficiary been the relevant question—but not for jurisdiction over the trustee. The beneficiary in the present case has connections to North Carolina, but, under *Hanson*, it is inappropriate to impute these connections to another party. This unwillingness reflects this Court's consistent policy that jurisdiction must be established against each defendant, individually; the contacts of one party cannot be imputed, willy-nilly, to another. *See Walden*, 571 U.S. at 284; *Burger King Corp.*, 471 U.S. at 475-76;

Helicopteros Nacionales de Colombia, S.A., 466 U.S. at 417; *World-Wide Volkswagen Corp.*, 444 U.S. at 298. In *Hanson*, this Court rested its unwillingness to allow Florida to refocus on the connections with the beneficiaries upon its interpretation of Florida law. 357 U.S. at 254. It held that Florida law required jurisdiction over the trustee, and that Florida law could not simply be departed from or altered ad hoc in order to make establishment of jurisdiction easier. *Hanson*, 357 U.S. at 254; *see* Brilmayer & Paisley, *Personal Jurisdiction and Substantive Legal Relations: Corporations, Conspiracies, and Agency*, 74 Cal. L. Rev. 1 (1986) (arguing that the forum may not depart from general domestic law principles of agency, piercing the corporate veil, attribution of responsibility, etc., simply because doing so would make possible the assertion of jurisdiction).

In the present case, as in *Hanson*, shifting the focus of the case would require manipulation of forum law regarding the identity of the real parties in interest. Forum law does not in either case authorize manipulation of the party structure simply because the forum (whether Florida or North Carolina) would like to be able to assert jurisdiction. As with Florida law in *Hanson*, under North Carolina law the beneficiary and the trustee are not interchangeable, nor can the contacts of the beneficiary be attributed to the trustee. *See, e.g.*, N.C. Gen. Stat. Ann. § 36C-1-103 (2019) (defining beneficiary and trustee separately); N.C. Gen. Stat. Ann. § 36C-2-202 (2019) (creating different rules for adjudicative jurisdiction over trustees and

beneficiaries of trusts with their principle place of administration in North Carolina); N.C. Gen. Stat. Ann. § 36C-4-402(a)(5) (2019) (requiring that the same person not be the sole trustee and sole beneficiary of a newly created trust). Application of bona fide North Carolina procedural policy would require jurisdiction over the trustee, not minimum contacts with the beneficiary.

This Court continues to adhere to the general principle that it is the contacts between the forum and the real party in interest that matter rather than the contacts between the forum and a non-party over whom jurisdiction would be more readily available. In *Rush v. Savchuk*, a passenger injured in a motor vehicle accident sued the driver in a state where jurisdiction over the driver would not have been available. 444 U.S. 320, 322-23 (1980). His strategy was to sue the driver's insurance carrier, instead. *Id.* This Court rejected the Minnesota Supreme Court's view that the contacts between the insurance company and the forum were sufficient basis for jurisdiction under the Due Process Clause; citing *Hanson*, it wrote:

> In short, it cannot be said that the defendant engaged in any purposeful activity related to the forum that would make the exercise of jurisdiction fair, just, or reasonable, see *Kulko v. California Superior Court*, 436 U.S. 84, 93-94 (1978); *Hanson v. Denckla*, 357 U.S. 235, 253 (1958), merely because his insurer does business there. Nor are there significant contacts between the litigation and the forum. The Minnesota Supreme Court was of the view

> that the insurance policy was so important to the litigation that it provided contacts sufficient to satisfy due process. The insurance policy is not the subject matter of the case, however, nor is it related to the operative facts of the negligence action. The contractual arrangements between the defendant and the insurer pertain only to the conduct, not the substance, of the litigation, and accordingly do not affect the court's jurisdiction unless they demonstrate ties between the defendant and the forum.

Id. at 329 (footnote omitted). The Court continued:

> The Minnesota court also attempted to attribute State Farm's contacts to Rush by considering the "defending parties" together and aggregating their forum contacts in determining whether it had jurisdiction. The result was the assertion of jurisdiction over Rush based solely on the activities of State Farm. Such a result is plainly unconstitutional. Naturally, the parties' relationships with each other may be significant in evaluating their ties to the forum. The requirements of *International Shoe*, however, must be met as to each defendant over whom the state court exercises jurisdiction.

Id. at 331-32.

The very strategy rejected in *Hanson v. Denckla*, and attempted in the case presently before us was in this way rebuffed in *Rush v. Savchuk*, as well.

But there is still another reason that North Carolina cannot simply decide, in effect, to substitute jurisdiction over the beneficiary for jurisdiction over the trustee. It relates to a third respect in which due process limits North Carolina's attempt to assert adjudicative jurisdiction or jurisdiction to tax against persons with which it has no contact. Due process limits all efforts by the forum to assert its authority over a dispute with which it has only the most negligible contact. Allowing North Carolina to refocus attention on the contacts with the beneficiary, rather than the trustee, would violate recognized constitutional principles regarding due process of law.

B. Due process principles limit state overreaching in the multistate context and prohibit attempts such as North Carolina's to acquire jurisdiction that would not otherwise exist.

Due process limits state authority in a wide range of multistate contexts, including not only the standard choice of law context in which the forum decides whether to apply its law or the law of another state (*see., e.g., Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 820-23 (1985) (invalidating blanket attempt to apply forum law to nationwide class action)) but also where the state seeks to refocus the jurisdictional inquiry to avoid its evident lack of connection with a party over whom jurisdiction is lacking (*see Hanson*, 357 U.S. at 247-52, and *Rush*, 444 U.S. at 327-33); in interstate criminal law (*see, e.g., Skiriotes v. Florida*, 313 U.S. 69,

78-79 (1941) (upholding application of Florida regulation prohibiting the taking of sponges with scuba equipment outside state territorial waters against due process challenge)) and in the permissibility of state tolling statutes alleged to discriminate against foreign corporations that are amenable to suit in the forum. (*see, e.g.*, *G.D. Searle & Co. v. Cohn*, 455 U.S. 404, 411-12 (1962) (upholding state statute against due process challenge)).

The limits that the Due Process Clause imposes are exemplified by the 1930 case of *Home Insurance Co. v. Dick*, 281 U.S. 397 (1930). A paradigm illustration of the ways that state overreaching can violate the Fourteenth Amendment, *Home Insurance* stands squarely for the proposition that a state may not assert its authority over a transaction that, when entered into, bore no connection to the state. The case deals, more specifically, with the special irrelevance of post-transaction change in domicile by one of the parties. *Home Insurance* gives meaning to the concept of due process limits on state overreaching in the multistate context, by providing an illustration of what it means for a state, put simply, to push things too far.

Home Insurance is in many respects a near perfect replica of North Carolina's attempt at imposing its tax law on the Kaestner Family Trust. *Home Insurance* involved an insurance policy which was written in Mexico and was to be performed in Mexico. *Id.* at 403-04. The risk that it covered was a tugboat located in Mexico and the contract contained a choice of law clause selecting Mexican law. *Id.* at 403. The loss occurred in

Mexico. *Id.* Both parties at that point resided in Mexico. *Id.* Subsequent to the occurrence of the insured-against risk, however, the contract was duly assigned to the plaintiff who, while then living in Mexico, maintained a permanent residence in Texas. *Id.*

In announcing its opinion, this Court described the facts of *Home Insurance* in the following terms:

> [N]othing in any way relating to the policy sued on, or to the contracts of reinsurance, was ever done or required to be done in Texas. All acts relating to the making of the policy were done in Mexico. All in relation to the making of the contracts of re-insurance were done there or in New York. And, likewise, all things in regard to performance were to be done outside of Texas. Neither the Texas laws nor the Texas courts were invoked for any purpose, except by Dick in the bringing of this suit. The fact that Dick's permanent residence was in Texas is without significance. At all times here material, he was physically present and acting in Mexico. Texas was, therefore, without power to affect the terms of contracts so made.

281 U.S. at 408-09. The Court then concluded, "[Texas] may not abrogate the rights of parties beyond its borders having no relation to anything done or to be done within them." *Id.* at 410.

Under these circumstances (this Court held) it would have violated the Fourteenth Amendment Due Process Clause for Texas to be permitted to regulate

the case. *Id.* at 408 ("Texas was therefore without power to affect the terms of contracts so made. Its attempt to impose a greater obligation than that agreed upon and to seize property in payment of the imposed obligation violates the guaranty against deprivation of property without due process of law."). The contractual choice of Mexican law was not to be over-ridden by a post-hoc move by one of the parties to Texas.[7] This Court rejected Texas' attempt to justify its application of Texas law as merely "remedial" or procedural, on the grounds that state choice of law principles regarding characterization of the issue would not avoid Texas' federal constitutional obligation.

The similarities between Texas' disregard for the exclusively Mexican location of all relevant events in *Home Insurance* and North Carolina's overreaching in the present case are striking. In effect, North Carolina is now seeking to impose a new duty on the trustee, contrary to the terms of the Trust agreement, and in violation of a clause selecting New York law to govern trust affairs.[8] The new duty—imposed without

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[7] The choice of law clauses in the two cases are important not so much for their literal applicability—because, in other words, they should be enforced as written so that the forum had to apply the other state's law—but because they underscore the parties' expectations. In the present case, neither party had the slightest reason to expect being subjected to North Carolina's taxing authority; in *Home Insurance*, application of Texas law was a complete surprise.

[8] The Trust was created in New York pursuant to a written agreement between the settlor, John Lee Rice, III and the trustee, William B. Matheson. *Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Dep't of Revenue*, 814 S.E.2d 43, 45 (N.C. 2018).

warning by a state wholly unconnected to the Trust agreement and whose identity would have been completely unpredictable at the time that the Trust was created—was a responsibility to defend cases brought in states where the trustee had no connections, simply because the beneficiary later chose to relocate there.

Most important of all, in both cases, was the complete absence of any connection to the state that would later end up seeking to impose its will upon the parties. Contacts between Dick's insurance contract and Texas—like contacts between the North Carolina and the Kaestner Family Trust in the present case—were simply nonexistent. Dick had no more than a nominal affiliation with Texas prior to the occurrence of the loss. In the present case, the beneficiary had never lived in North Carolina at the point that the Trust instruments were drafted, and there was no reason to assume that she ever would. Just as no one would have had reason to expect the application of Texas law in *Home Insurance*, at the time that the creation of the Trust was completed in the present case, no one would have predicted application of the law of North Carolina.

Matheson was later replaced as trustee by David Bernstein, a Connecticut resident. *Id.* Bernstein acted as trustee and remained a Connecticut resident during the relevant time period. *Id.* The assets of the Trust, consisting of various financial investments, were held by custodians located in Boston, Massachusetts. *Id.* No party to the Trust had any contact with the state of North Carolina until one Trust beneficiary relocated to North Carolina in 1997. *Id.*

This Court continues to cite *Home Insurance* as authoritative. In 1981, a plurality of *Allstate Ins. Co. v. Hague* described *Home Insurance* as one of two "instructive examples" of states violating the Due Process Clause by applying local law to contracts utterly lacking in forum contact. 449 U.S. 302, 309 (1981). The first of these was *Home Insurance* and the second was *John Hancock Mutual Life Ins. Co. v. Yates*, 299 U.S. 178 (1936). Both cases involved claimants who relocated to the forum after the transaction was completed, having had no connections with the forum at the time of the transaction. The Court summarized *John Hancock*:

> [In *Yates*] the insurer, a Massachusetts corporation, issued a contract of insurance on the life of a New York resident. The contract was applied for, issued, and delivered in New York where the insured and his spouse resided. After the insured died in New York, his spouse moved to Georgia and brought suit on the policy in Georgia. Under Georgia law, the jury was permitted to take into account oral modifications when deciding whether an insurance policy application contained material misrepresentations. Under New York law, however, such misrepresentations were to be evaluated solely on the basis of the written application. The Georgia court applied Georgia law. This Court reversed, finding application of Georgia law to be unconstitutional.

449 U.S. at 309-10. Most pointed of all was this Court's pithy summary of the meaning of the two "instructive examples." *Id.* at 309. The Court summarized, "*Dick*

concluded that nominal residence—standing alone—was inadequate; *Yates* held that a post-occurrence change of residence to the forum State—standing alone—was insufficient to justify application of forum law." *Id.* at 311.

To this day this Court has not abandoned the principle that neither "nominal residence" nor "a post occurrence change of residence to the forum state," standing alone, is enough to satisfy the Due Process Clause.

CONCLUSION

The Due Process Clause would clearly be offended if North Carolina were free to overlook the absence of minimum contacts, override party choice, honor a post-transaction change in domicile and uphold the application of state authority that simply could not have been predicted at any relevant point in time during the transaction. Accordingly, the judgment of the North Carolina Supreme Court should be affirmed.

Respectfully submitted,

WILLIAM D. ZABEL
Counsel of Record
CATHERINE GREVERS SCHMIDT
JOHN J. RECTOR
SCHULTE ROTH & ZABEL LLP
919 Third Avenue
New York, New York 10022
212-756-2000
william.zabel@srz.com
catherine.schmidt@srz.com

No. 18-457

In the Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,
Petitioner,

v.

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST,
Respondent.

On Writ of Certiorari to the North Carolina Supreme Court

BRIEF FOR CERTAIN STATE TRUST AND BANK ASSOCIATIONS AS AMICI CURIAE IN SUPPORT OF RESPONDENT

David M. Lehn
Counsel of Record
Stanley N. Bergman
William J. Kambas
James I. Dougherty
Withers Bergman LLP
1700 East Putnam Avenue
Suite 400
Greenwich, Connecticut 06870
(203) 302-4100
david.lehn@withersworldwide.com

Counsel for Amici Curiae

Becker Gallagher · Cincinnati, OH · Washington, D.C. · 800.890.5001

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STATEMENT OF INTEREST OF AMICI CURIAE[1]

Pursuant to Supreme Court Rule 37, six professional associations, dedicated to serving the growing interest in each of their respective states and across the nation in professional trust administration, respectfully submit this brief of amici curiae in support of Respondent. Amici curiae consist of the South Dakota Trust Association, New Hampshire Trust Council, Estates and Trusts and Taxation Sections of the Delaware Bar Association, Nevada Trust Company Association, Delaware Bankers Association, and Tennessee Bankers Association (together, the "Trust Associations").

Each Trust Association serves as the professional and trade association for its respective state's trust industry by promoting, educating, and supporting the professionals, judiciaries, legislatures, clients, and organizations engaged with trusts and trust management. Each of the Trust Associations strives to enhance its members' ability to be preeminent providers of fiduciary and trust services for families not only in their respective states, but also located throughout the country and world, while also

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[1] In accordance with Supreme Court Rule 37.6, the amici curiae state that no party other than amici, their members and their counsel have made a monetary contribution to fund the preparation and submission of this brief. Neither counsel for the Parties nor the Parties were involved in any way in this brief, to include by participation in its preparation or in the funding thereof. Both Parties have filed letters granting blanket consent to the filing of amicus briefs.

furthering the interests of its respective state and its citizens and, in turn, the continuous establishment and refinement of the statutory, regulatory, and judicial landscape affecting trusts and trust companies.

This brief will endeavor to assist the Court in considering the practical and administrative implications of the issue, particularly with respect to discretionary trusts and their management.

SUMMARY OF ARGUMENT

The question before the Court is whether the single fact of a resident discretionary beneficiary gives North Carolina the right to tax the accumulated income of an out-of-state trust.

In this case, the issue is not whether North Carolina may tax a beneficiary on trust distributions, but instead whether North Carolina may tax undistributed income in a trust with no ties to North Carolina other than a discretionary beneficiary residing in the state.

This case presents an important question relating to historic trust jurisprudence and its application consistent with other taxable entities. This Court's holding in *South Dakota v. Wayfair*, 138 S. Ct. 2080 (2018), altered but did not eliminate minimum nexus thresholds. Reversal of the decision of the North Carolina Supreme Court in this case would eliminate such constitutional standards, to the detriment of the orderly administration of state and federal tax systems.

Established law on the taxation of discretionary trusts, including the law of Petitioner (North Carolina), clearly proves that the residence of a discretionary

beneficiary does not provide sufficient nexus for the imposition of income taxes by a state on the trust's worldwide income. The decision of the North Carolina Supreme Court and the prior precedent of this Court do not create "a judicially created tax shelter" as Petitioner contends, because current law concerning the taxation of trusts and beneficiaries ensures no such abuse occurs. The constitutional and policy concerns addressed in this brief, as well as the practical impact of accepting the Petitioner's position, demonstrate that the Court should reject Petitioner's arguments and uphold the decisions below.

ARGUMENT

I. A DISCRETIONARY BENEFICIARY LACKS SUFFICIENT CONNECTION TO THE ASSETS OF A TRUST TO PROVIDE A JURISDICTIONAL NEXUS

In an attempt to create a connection between the State and the income the State wishes to tax, North Carolina has based its taxation of a trust on a beneficiary's residence and, by doing so, disregards the meaningful distinction between a trust and its beneficiary. Resolution of this issue before the Court, then, in large part, turns on what a trust is and what a trust is not. To conflate a trust with its beneficiary is to disregard basic tenets of trust law, especially where distributions of income and principal are subject to the discretion of its fiduciary. This Court has previously rejected this notion, *see, e.g.*, *Brooke v. Norfolk*, 277 U.S. 27, 29 (1928), and the Court should once again reject it here.

A beneficiary of a discretionary trust[2] has no rights to or expectancy of a distribution of the trust assets. Respondent ("Kaestner Trust") is such a discretionary trust because the trustee has complete discretion over trust distributions (subject to an implied obligation of good-faith, as required by New York law, e.g. *O'Hayer v. De St. Aubin*, 30 A.D.2d 419 (1968), which governs this Trust) and the ultimate power to determine what distributions, if any, will be made. Resp't Br., at 3; Joint App., at 46, 62 (§§ 1.2, 5.8(a) of the Kaestner Trust).

The terms of a trust establish the rights and obligations of the parties. A trust creates a fiduciary relationship by agreement between a transferor of certain property (the settlor[3]) and one or more persons (the trustee or trustees) who receive and hold legal title to that certain property for the benefit of one or more others (beneficiaries). Restatement (Third) of Trusts § 2

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[2] Going forward, the term "discretionary trust" shall refer to a trust such as Respondent, the terms of which (1) grant trustees complete control over whether to make distributions from the trust, and (2) do not cause taxation of income to its settlor under Internal Revenue Code ("I.R.C.") §§ 671-679, the "Grantor Trust" rules. The term could be appropriately applied to a broader range of trusts, but for purposes of illustrating the arguments central to this brief, the term will be limited in its meaning unless otherwise specified. The term "discretionary beneficiary" will be used to refer to a beneficiary of a discretionary trust.

[3] The words "settlor," "donor," "trustor," and "grantor" can be interchangeable, and typically refer to the creator of a trust. This brief will use the word "settlor" to reflect the prevalent term used in North Carolina trust law, the state of the statute under scrutiny.

(2003). A trust is the product of its settlor's wish to transfer an interest in property to or for someone else, subject to particular conditions established by the settlor. The trust terms are a legal agreement reached between settlor and trustee (and not beneficiary) and set conditions that the settlor attaches to the property, as well as the duties to which the trustees must adhere. The trust beneficiary's rights are circumscribed by the trust terms. Restatement (Third) of Trusts § 49 (2003). A trustee is charged with duties and granted powers and rights over trust property to carry out those duties; a beneficiary has no rights over the trust property other than those expressly conferred to him or her under the terms of the trust, Restatement (Third) of Trusts § 50 (2003), and, in turn, owes no duty or obligation to the trustee or trust.[4]

While all trusts exist with reference to three constituencies – settlor, trustee and beneficiary[5] (the "trust triad") – in the case of a discretionary trust, the relationship between trust and beneficiary is especially remote. As the following sections will explain, a

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[4] A beneficiary generally has no personal liability to the trust, Restatement (Third) of Trusts § 104 (2003), nor to third parties for obligations incurred by trust or trustee, Restatement (Third) of Trusts § 103 (2003), and only becomes liable to the trust or related third parties such as through debt or malfeasance involving trust or trustee. In fact, a trust may be created without definite beneficiaries. Restatement (Third) of Trusts § 44 (2003).

[5] Note, a trust can exist without a beneficiary, for example a non-charitable purpose trust which has no beneficiaries and instead its sole purpose is to care, protect and/or preserve an asset, or trusts created without definite beneficiaries at the onset. Restatement (Third) of Trusts § 44 (2003).

beneficiary of a discretionary trust fundamentally lacks sufficient rights over the property of that trust for the contacts of that beneficiary to be imputed to the entire trust.

A. A Discretionary Beneficiary Has No Present or Future Ownership Interest in the Trust

Before creating a trust, the settlor holds both the legal title to and beneficial interests in the property with which she will fund the trust. As owner of that property, she is free to enjoy the property and manage it in her interests, including consuming, using, gifting or donating the property. But in transferring it to trust, the settlor severs benefit from control: she confers the benefit in that property to the trust beneficiaries, but grants exclusive legal rights and control over that property to the trustee. Restatement (Third) of Trusts § 2 (2003); *Greenough v. Tax Assessors of Newport*, 331 U.S. 486, 494 (1947). The beneficiary does not have any legal title to the trust assets, as the trustee is the legal owner. *See, e.g.*, *Anderson v. Wilson*, 289 U.S. 20, 24 (1933). Further, the interest held by a discretionary beneficiary does not and cannot exhibit any indicia of ownership to justify disregarding the trust's structure by equating the beneficiary with the trust.

i. A Discretionary Beneficiary Neither Controls Nor Owns Trust Property

All control over trust assets is vested in the trustee alone.[6] It is a trustee's duty alone to take and keep exclusive control of trust property. *See* Restatement (Second) of Trusts, §175 & cmt. f (1957). A beneficiary has no control over trust assets. This is fundamental to the nature of a trust.[7]

Every U.S. jurisdiction that imposes a tax on trust income recognizes a beneficiary's lack of control over trust assets because it is the trustee, not the beneficiary, who must file a tax return and pay any tax due by the trust. For example, the North Carolina statute at the center of this controversy specifically directs that the trustee "shall pay the tax" imposed on a trust by that part. N.C. GEN. STAT. § 105-160.2. Section 6012(b)(4) of the Internal Revenue Code of 1986, as amended ("I.R.C."), similarly directs that

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[6] By extension, a trustee – and not the beneficiaries – is liable for any losses incurred as a result of trustee's breach of trust in the management of trust assets. Restatement (Third) of Trusts § 100 (2003); *see also Greenough*, 331 U.S. at 494; *Brooke v. Norfolk*, 277 U.S. 27, 29 (1928).

[7] A trustee's powers are set by the terms of the trust and by local law, and generally include the full breadth of powers necessary to manage trust assets and administer the trust. Under the Uniform Trust Code § 815 and North Carolina General Statutes § 36C-8-815, the trustee may exercise all general powers to achieve the proper management and administration of trust property. *See also* Restatement (Third) of Trusts § 70 (2003); Restatement (Second) of Trusts § 186 (1957).

returns of a trust "shall be made by the fiduciary thereof," that is, by the trustee.

This Court has long recognized that control reflects ownership, from which it follows that, as the sole party in control, the trustee of a trust is the owner of trust assets. *See e.g.*, *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83, 92 (1929); *see also Brooke v. Norfolk*, 277 U.S. 27, 29 (1928). Beneficiaries of a discretionary trust have no control over assets held by the trust through their status as beneficiaries, and not only lack legal title, but also lack any legally recognized property interest in the trust property.

Many areas of law recognize a discretionary beneficiary's lack of a property interest in a trust. For example, under both state and federal law, a discretionary beneficiary's creditors generally cannot reach the assets of the trust.[8] North Carolina is representative of many states that have codified this principle by adopting the Uniform Trust Code and its provisions regarding creditor claims.[9] The North

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[8] Restatement (Second) of Trusts § 155(1) & cmt b (1957); *but see* note 11, *infra*; N.C. GEN. STAT. § 36C-5-504(b) (2018) (examples of instances in which the creditors of a discretionary beneficiary *could* reach trust assets.) Such instances where a discretionary beneficiary's creditor could reach trust assets arise under unique circumstances that are far beyond the fact pattern in this case.

[9] A version of the Uniform Trust Code (UTC) has been adopted by 34 states and the District of Columbia. *See* Unif. Law Comm'n, Trust Code, https://www.uniformlaws.org/committees/community-home?CommunityKey=193ff839-7955-4846-8f3c-ce74ac23938d (last visited Mar. 22, 2019). Article Five of the UTC is consistent

Carolina Uniform Trust Code specifically provides that "a creditor or assignee of a beneficiary may not reach a discretionary trust interest." N.C. GEN. STAT. § 36C-5-504(a)(2), (b) (2018). It is not surprising that all of the courts in North Carolina that considered Petitioner's arguments refused to find that the beneficiaries had any ascertainable interest under local law giving rise to a jurisdictional nexus over the trust.

Ms. Kaestner's interest in the trust would not even constitute property in a bankruptcy estate. Pursuant to 11 U.S.C. § 541(a) (2018), a debtor's bankruptcy estate is comprised of "all legal and equitable interests of the debtor in property at the commencement of the case." Because Ms. Kaestner cannot transfer her interest in the trust,[10] her interest would not be part of her bankruptcy estate. 11 U.S.C. § 541(c)(2) (2018); *see also In re Pugh*, 274 B.R. 883, 885 (Bankr. D. Ariz. 2002). Further, North Carolina precludes creditors from reaching such interests. N.C. GEN. STAT. § 36C-5-502(c) (2018). This Court has long found similarly. *See e.g., Nichols v. Eaton*, 91 U.S. 716, 724 (1875).

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with the foregoing description of North Carolina law and reflects a concept prevalent throughout trust law.

[10] In many states that restriction is codified into law, e.g. N.C. GEN. STAT. § 36C-5-504(b) (2018), and some trusts, such as the Kaestner Trust, specifically prohibit a beneficiary from transferring his or her interest. Joint App., at 70 (Article TWELFTH of the Kaestner Trust). Whether or not that prohibition is codified, the fact remains that a beneficiary has no mechanism for transferring an interest in a discretionary trust (nor even an identifiable interest to attempt to transfer).

Recognition that a discretionary beneficiary owns no assets of the trust is not limited to the creditor context. Federal and state income tax laws respect that a discretionary beneficiary is not the owner of trust property by taxing the trust, and not the beneficiary, on income earned and retained by the trust. I.R.C. § 641. Similarly, at the death of a discretionary beneficiary, trust assets are not included among her assets subject to estate taxes. I.R.C. § 2031. North Carolina's attempt to tax the trust in this case is directly at odds with these principles.

ii. A Discretionary Beneficiary Has No Expectancy of Future Ownership of Trust Property

A discretionary beneficiary does not own trust property and, importantly, may never own any trust property. In their amicus brief in support of Petitioner, Stephen Feldman *et al.* claim that "only a trust's beneficiary is entitled to trust income." Brief for Law Professors as Amicus Curiae, supporting Petitioner, at 2, 7. That statement is misleading. In fact, a discretionary beneficiary has no entitlements unless granted to him or her by the trust terms, and is not entitled to income as a matter of course. Income of a discretionary trust may be used to pay expenses or taxes, added to principal, or ultimately distributed to a different beneficiary. Thus while a discretionary beneficiary *may* receive property at some point in time, such beneficiary has no legally recognized expectancy of ownership and is certainly not entitled to receive trust property in a given tax year or any year.

The Kaestner Trust is a discretionary trust. Pet'r's Br., at 3. As with discretionary trusts generally, the trustee's control extends beyond trust management to decisions over distributions to beneficiaries – when, to which beneficiaries, of how much, and critically, whether to make any distributions in the first place. Pet'r's Br., at 3. The beneficiary has no legal right to receive trust income or principal, or enforceable expectancy of receiving it in the future. Brief for the American College of Trust & Estate Counsel as Amicus Curiae, supporting neither party ("ACTEC Br."), at 7. In fact, a discretionary beneficiary could pass away without ever receiving a distribution from the trust. A discretionary trust beneficiary has no discernible right to trust assets, because all power to make (or not make) distributions is vested in the trustee, who is authorized under the terms of the trust agreement to make no distributions at all.

In the trust context, the word "benefit" (and by extension, beneficiary) is a term of art: to say that trust property must be held "*for the benefit of*," Restatement (Second) of Trusts § 2 (1957); Restatement (Third) of Trusts § 2 (2003), one or a class of beneficiaries is not an affirmative statement describing a benefit to be received by such "beneficiaries," but should be read in the negative, to mean that trust property must not be held with the intent to benefit *anyone else* outside of the designated class.[11] Although the terms of a

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[11] Among a trustee's fiduciary duties is the duty of loyalty, requiring that the trustee administer the trust solely in the interest of the beneficiary. *See e.g.* Restatement (Second) of Trusts, § 170(1) (1957); Restatement (Third) of Trusts, § 78(1) (2003).

particular trust may confer affirmative, appreciable benefits upon a beneficiary, a discretionary trust grants no such benefits to a beneficiary absent an act of the trustee. A discretionary beneficiary has neither a present property interest in, nor an expectancy of future ownership of, trust property unless and until a trustee makes a distribution from the trust to the beneficiary. If and when a trustee chooses to make a distribution from a discretionary trust, the beneficiary receiving such distribution will have the distributed property in hand and it will have ceased to be trust property.[12] Thereafter, the property is owned by the beneficiary and thus taxable to the beneficiary.

B. The State Provides No Benefits to the Trustee or for the Assets Held in Trust

A number of briefs in favor of Petitioner contend that the Trustee or the assets held in the Kaestner Trust benefit directly from the services and protections North Carolina offers to the trust beneficiaries. They assert that the trust would be required to deplete trust assets in the absence of the services the State provides to the resident beneficiaries (as well as all residents of North Carolina). *See, e.g,* Pet'r's Br., at 17, 31; Brief for Minnesota, Nineteen Other States & the District of Columbia as Amicus Curiae, supporting Respondent ("Minn. Br."), at 15-16. This argument is misdirected for a number of reasons, two in particular. First, it disregards the fact that the Kaestner Trust is a

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[12] Furthermore, under I.R.C. §§ 661(a) and 662(a), the beneficiary (and not the trust) will be subject to taxation on the share of trust income carried out to him or her through the distribution.

discretionary trust, and second, it relies on contacts that are too remote and attenuated.

The trustee of the Kaestner Trust has no obligation to make any distributions to a trust beneficiary, whatever the purpose. Were there a shortfall in state services from which beneficiaries suffered, the trustee would be under no obligation to distribute trust assets to fill that gap. Similarly, the Trustee may make a distribution to provide a beneficiary with services in addition to those provided by the state. For example, North Carolina offers public education to its residents but the trustees of the Kaestner Trust have discretion to distribute (or refuse to distribute) funds to send a North Carolina-resident beneficiary to private school. As this illustrates, there is no essential relationship between the services and protections North Carolina offers to its residents and the trustee's obligation (or lack thereof) to make distributions to beneficiaries.

The North Carolina resident beneficiaries moved into the state of their own accord (or were born there, as the case may be). The beneficiaries are appropriately taxed in North Carolina on their income like all state residents and in turn have access to the same resources as other residents. A discretionary beneficiary's unilateral choice of residence – and unilateral benefit from that residence – does not reflect a benefit to a trust, and cannot reasonably be used to tie a discretionary trust to a beneficiary's state of residence.[13] The trust, on the other hand, did nothing

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[13] Unilateral activity of a third party, claiming a relation to the nonresident party, cannot satisfy this requirement of contacts with

to direct itself towards North Carolina, as the trustee did not seek or rely on any benefits from the state.

Petitioner erroneously claims that the Kaestner Trust directed itself towards North Carolina's "sound local banking institutions" in making a loan to Ms. Kaestner. Pet'r's Br., at 36. Had the trust loaned money to an independent third party living and banking in a third state, it arguably would have benefitted similarly from that state's banking institutions, but such benefit would not have caused the worldwide income of the trust to be subject to income tax in that state. The straws Petitioner grasps for, in an attempt to weave a colorable argument of sufficient connection with the State, are simply non-existent and unable to pull all trust assets into Petitioner's taxing net.

II. NORTH CAROLINA'S APPROACH TO TRUST TAXATION IS UNUSUAL AND UNCONSTITUTIONAL

Petitioner and its amici argue that upholding the decision of the North Carolina Supreme Court would impact the trust taxation regimes of a myriad of states and throw state taxation of trusts, and state revenue therefrom, into disarray. Pet'r's Br., at 39-43. That is simply not the case. The North Carolina trust taxation statute is not only at odds with the Constitution, but also an outlier among state trust

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the state; instead, the actual party must purposefully avail itself of the privileges of acting within the state and of the benefits and protections of the state's laws. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 474-76 (1985).

taxation statutes. Any trust taxation statute based on a single factor analysis is unusual, and, where that single factor involves solely the residence of a settlor or beneficiary, is inadequate to establish constitutionally sufficient connection.

A. North Carolina's Statute and Other Single-Factor Tax Analyses are Unusual and Contrary to National Standards of Fairness

Contrary to Petitioner's assertion, the North Carolina trust taxation statute is an outlier. Pet'r's Br., at 6. Of the 51 jurisdictions in the United States, only North Carolina and Georgia[14] take the position that a discretionary beneficiary residing in the state *may* subject the trust to taxation in that state. GA. CODE ANN. §48-7-22(a)(1)(C) (2018); GA. COMP R. & REGS. 560-7-3-.07(3)(b) (2018).

Every other state that considers a beneficiary's residence in taxing trusts applies a multi-factor analysis to determine whether a trust is subject to tax in that state. Without seeking to comment on the constitutionality of either, the Connecticut and California trust taxation statutes offer two examples of multi-factor analyses that consider residency of beneficiaries – but critically, take other factors into

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[14] Tennessee had previously employed a similar tax system, see TENN. CODE ANN. §§ 67-2-102, 67-2-110(a) (2014), but is amending their law and will no longer tax income (of trusts or otherwise) on this basis, as of 2021. Tenn. Dep't of Rev., Notice #17-09 (May 2017), *https://www.tn.gov/content/dam/tn/revenue/documents/notices/income/income17-09.pdf.*

account as well. Also without comment on their constitutionality, the California and New York statutes illustrate another approach to taxation based on beneficiary residence, imposed on previously untaxed income upon distribution to such beneficiary. All such statutes point to the superficiality and inadequacy of Petitioner's approach by providing a level of analysis that is lacking in the North Carolina statute.

The Connecticut trust taxation statute defines a "resident trust" with reference to the settlor's state of residence, and only taxes resident trusts on the trust's worldwide income. CONN. GEN. STAT. § 12-701 (2018). If a resident trust has a noncontingent beneficiary that resides outside of the State, Connecticut will tax only the resident noncontingent beneficiaries' proportionate share of the trust income. *Id.* Even if Ms. Kaestner moved to Connecticut, her residency would never suffice to cause the Kaestner Trust to be taxed under the Connecticut statute because it is a fundamentally nonresident trust. Notably, a beneficiary's residence comes into play only after consideration of settlor's residence, and only then in the case of a noncontingent beneficiary; the beneficiary's residence is also not sufficient to cause the trust to be considered "resident" to Connecticut, as that is defined based on the settlor.

California presents an interesting example because, though often cited as a state that taxes trusts based upon the residence of a beneficiary, it in fact takes a much more nuanced approach. Like Connecticut, California requires that the resident beneficiary upon whom trust taxation is based be one with a "non-contingent" interest, that is, in California's conception

not a discretionary beneficiary. CAL. REV. & TAX CODE § 17745 (Deering 2019). If a trust only has discretionary beneficiaries resident in California, the trust will not be subject to tax in California as a result of the beneficiaries' residence. CAL. REV. & TAX CODE § 17745 (Deering 2019); *Appeals of Yolanda King Family Trust and Mary L. Tunney Jr. Trust I*, Nos. 357825, 357829, 2007 Cal. Tax LEXIS 406 (State Bd. Equalization of Ca. Oct. 4, 2007).

California also imposes a "throwback" tax on a discretionary beneficiary, but not the trust, see CAL. REV. & TAX CODE §§ 17742, 17745(c), 17745(b), which is a reflection of historic U.S. tax law on trusts that was repealed in 1997. *Subchapter J — Throwback Rules*, Est. Gifts & Trusts (BNA) 856-2nd, at I.B. The current California statute states that "if no taxes have been paid on the current or accumulated income of the trust because the resident beneficiary's interest in the trust was contingent, such income shall be taxable to the beneficiary *when distributed or distributable to him or her*." CAL. REV. & TAX CODE § 17745(b) (Deering 2019) (emphasis added). In other words, California delays its tax until the element of discretion is resolved—when the beneficiary has the distribution in hand and the connection between trust property and beneficiary is certain. Still, it is the *beneficiary* that is subject to the eventual tax, not the trust.

New York also incorporates a throwback tax on resident beneficiaries. New York generally determines the residency of a trust with reference to the residence of its settlor, but other factors are also considered. N.Y. TAX LAW § 605(b)(3)(B)-(C) (2019). New York

taxes the worldwide income of resident trusts, but also creates an exemption for trusts with no New York trustees, assets or source income. N.Y. TAX LAW § 605(b)(3)(D)(i) (2019). New York imposes no tax on a trust as a result of beneficiaries' residence, whether contingent or noncontingent; instead, it taxes the accumulated income of a New York resident trust only upon receipt by a New York beneficiary. N.Y. TAX LAW § 612(b)(40) (2019).

The North Carolina statute, by contrast, simply taxes income of a trust that is "for the benefit of a resident of" that state, N.C. GEN. STAT. § 105-160.2, and from the way it was applied to the Kaestner Trust, it is clear that the State declines to infer any nuance from that instruction. In applying its statute, North Carolina disregards the myriad of other factors that establish a trust's contact with states, and paints all beneficiaries – even beneficiaries with exceedingly remote contacts to a trust, who may never benefit from trust property – with one broad brush; this application obscures the immense variety that can be accommodated by that term.

B. Courts Have Not Upheld Taxation Based on a Single-Factor Analysis

Petitioner cites a number of state court opinions as justification for the North Carolina statute. Examination of these cases, however, illustrates the state statutes under consideration were materially different from North Carolina's. Nevertheless, the reasoning in these other state court cases further illuminates that a single-factor analysis for imposing taxation is simply insufficient.

Numerous states have found that multiple factors need to be considered in order to find sufficient connection for the state to constitutionally tax the trust's entire worldwide undistributed income. *See, e.g.*, *Fielding v. Comm'r of Rev.*, 916 N.W.2d 323, 332-33 (Minn. 2018); *Linn v. Dep't of Revenue*, 2 N.E.3d 1203, 1210 (Ill. App. Ct. 2013); *McNeil v. Pennsylvania*, 67 A.3d 185, 194-95 (Pa. Comm. Ct. 2013)(Commerce Clause); *In re Swift*, 727 S.W.2d 880, 882 (Mo. 1987); *Westfall v. Director of Revenue*, 812 S.W.2d 513, 514 (1991). Lessons derived from three states, in particular, are illustrative of the necessity to employ a multifactor analysis when evaluating the taxation imposed on a trust's accumulated income.

In Pennsylvania, the State attempted to tax a trust's income based on the residence of a beneficiary. The attempt was rejected. In *McNeil v. Pennsylvania*, the court found it was unconstitutional to tax a trust on its earned income and capital gains with no other connection to the state other than the grantor's residence at the time the trust was established and the residence of the discretionary beneficiary with no current or future rights to the trust assets. *McNeil*, 67 A.3d at 198. The State of Pennsylvania asserted the same argument as the Petitioner: the settlor and the discretionary beneficiaries benefited from the state's legal framework, which "in turn" benefitted the trust whose purpose was to support the beneficiaries. This argument was rejected by the Pennsylvania court because the beneficiary was not the taxpayer and the trust did not directly benefit from the state's protections or benefits, including the state's roadways,

bridges, fire protection, economic markets or access to courts.

Connecticut also attempted to tax a trust's accumulated income. In *Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999), the court was asked to consider Connecticut's trust taxing statute, which is not a single-factor statute. Connecticut's statute only imposes a tax on an inter vivos trust if it is a "resident trust" which is defined as a trust that became irrevocable when the settlor was a domiciliary. Petitioner's brief misrepresents the holding of *Gavin*. Connecticut's statutory law allows for a reduction—not the imposition—of taxes if non-contingent beneficiaries live outside of the state. In *Gavin*, the only current beneficiary was domiciled in Connecticut and had current mandatory rights to income and ultimately principal—as opposed to a discretionary beneficiary as in the present case. Therefore, the holding in *Gavin* is that if the only current beneficiary of a trust who is entitled to mandatory income is domiciled in Connecticut, the trust is not able to claim a reduction. This holding does not assist Petitioner.

California's jurisprudence also supports a multifactor analysis to taxing a trust's accumulated income. Petitioner cites *McCulloch v. Franchise Tax Board*, 390 P.2d 412 (Cal. 1964) as central to Petitioner's argument, but it is clearly distinguishable. Pet'r's Br., at 30, 33. First, the *McCulloch* court was concerned with California's throwback tax, discussed above, and not the taxation of a trust based on beneficiary residence. Second, in *McCulloch*, the trust had a resident trustee (incidentally, the beneficiary in

question). Third, and most importantly, in *McCulloch*, the California beneficiary had received a terminating distribution and thus had all trust assets in hand, cementing the connection between assets and beneficiary. *McCulloch*, supra, at 188. Petitioner's attempts to apply *McCulloch* to connect a discretionary beneficiary to a trust fail because the *McCulloch* court did not have to make that connection: Mr. MuCulloch's connection to the trust was plainly evidenced by his receipt of all trust assets. That cannot be said of any of the beneficiaries of the Kaestner Trust.

The statutes and cases described above illustrate the importance of a multifactor analysis to evaluating the "residency" of a trust, and that many states are already moving in this direction. They also illustrate the importance of rejecting a single-factor approach to taxing trusts.

III. THE NORTH CAROLINA SUPREME COURT DECISION PROTECTS FUNDAMENTAL RIGHTS

A. Upholding the North Carolina Supreme Court Decision is Consistent with Federalism and Due Process

i. Federalism and State Sovereignty Require the Balance the Respondent Seeks

Federalism balances the sovereignty of the states with the power of the federal government. States have always had the power to levy taxes in order to raise their own revenue, independent of the Federal government. *Dows v. Chicago*, 78 U.S. 108, 110 (1870).

However, the state taxing power is not boundless; a state's power to tax is necessarily constrained by the Fourteenth Amendment. *Conn. Gen. Life Ins. Co. v. Johnson*, 303 U.S. 77, 80 (1938). The decision of the North Carolina Supreme Court does not infringe on a state's valid exercise of sovereign power; rather, it gives effect to the boundary between the outer limit of state sovereignty and the constitutional guarantees of the Due Process Clause. *See also Greenough*, 331 U.S. at 497.

Petitioner selectively relies on the Court's opinion in *McCulloch v. Maryland*, 17 U.S. 316 (1819), for the proposition that the "states' authority to tax is a cornerstone of federalism," Pet'r's Br., at 19, but ignores the limitations of federalism set by the same court with respect to a state's power to tax. To read *McCulloch v. Maryland* as endorsing the use of federalism to obscure deficiencies in a state tax scheme, as Petitioner appears to do, is to overlook the opinion's strong language describing the "paramount character of the Constitution" such that the Constitution "may restrain... a State from such [exercise of its taxing power]... as is in its nature incompatible with, and repugnant to, the constitutional laws of the Union." *McCulloch v. Maryland*, 17 U.S. at 425.

Rejecting the North Carolina statute is not a rejection of the principles of federalism, but rather a recognition and endorsement of the outer boundary of state sovereignty to tax, compatible with "the constitutional laws of the Union," *McCulloch v. Maryland*, 17 U.S. at 425, which is the very aim of federalism.

ii. Application of 14th Amendment Protections Prevent Petitioner's Position

Upholding the decision of the North Carolina Supreme Court serves to defend not only the aims of federalism, but also the protections of the Due Process Clause consistent with existing standards of taxation, broadly. The defense of both requires the rejection of Petitioner's position.

Recent decisions of this Court have sought to update Commerce Clause jurisprudence with respect to state taxation in light of technological and societal changes that have unfolded in the time since seminal decisions were written.[15] However, no technological or societal changes have broken down distinctions among the components of the trust triad to justify such a drastic deviation from precedent regarding trusts.

Under the Due Process Clause as applied to state taxation, there must be a definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax, and the income attributed to the state for tax purposes must be rationally related to values connected with the taxing state. *Quill*, 504 U.S. at 306-07. The minimum contacts analysis of

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[15] The Court's opinion in *South Dakota v. Wayfair* rests, in part, on reconsidering Commerce Clause precedents interfering with the State exercise of sovereign powers and recognition of the deficiencies of the Commerce Clause analysis in *Quill* in a contemporary setting. *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2088-89, 2092 (2018); *Quill Corp. v. North Dakota*, 504 U.S. 298, 306-07 (1992).

International Shoe Co. v. Washington, 326 U.S. 310 (1945), as articulated in *Hanson v. Denckla*, 357 U.S. 235, 253 (1958), to include the requirement of purposeful availment, and as further developed in subsequent cases, is applied to determine whether the minimum connection exists for the state to assert its taxing authority over a given taxpayer. *Int'l Shoe Co.*, 326 U.S. at 316; *Hanson*, 357 U.S. at 251; *Kulko v. Superior Ct. of Cal.*, 436 U.S. 84, 92 (1978); *Asahi Metal Indus. Co. v. Superior Ct. of Cal.*, 480 U.S. 102, 108-09 (1987). Because a trust, through its trustee, is that taxpayer, the use of state contacts of a discretionary beneficiary in asserting tax jurisdiction over the trust's accumulated income distorts the longstanding distinctions of the trust triad.

No matter the taxpayer, no matter the activity, the measure for the constitutional nexus depends on the quality and nature of the activity in relation to the fair and orderly administration of the applicable tax law. *Int'l Shoe*, 326 U.S. at 319. An important analogue is found in the treatment of corporations. Corporations can and should expect to be taxed on activities that occur in the place of their incorporation (akin to where they reside) and also in the place(s) where they purposefully maintain property, hire employees or agents, or generate sales, but states do not exert taxing authority over corporate earnings based on the residence of the shareholders prior to the payment of dividends. Even then, it is the shareholder that is taxed on the dividend received, not the corporation.

The Revised Model Business Corporations Act, on which North Carolina's Business Corporations Act is

based, N.C. GEN. STAT. § 55-15-01 et seq. (2018), sets forth a framework for evaluating whether a foreign corporation is considered to be transacting business in the state; the statute expressly excludes loaning and borrowing funds and maintaining bank accounts from being considered sufficient activities causing a foreign corporation to be considered to have transacted business in the state. Revised Model Business Corporation Act § 15.05 (ABA Bus. Law Section 2016). These activities are excluded from consideration for purposes of North Carolina corporate tax on foreign corporations, N.C. Gen. Stat. § 55-15-01, and similar activities conducted by a nonresident trustee should be similarly viewed as excluded activities in the analogous context of income taxation of trusts.[16]

B. Sound Tax Policy is Preserved Between and Among the Federal Government and State Governments by Upholding the North Carolina Supreme Court

The federal and state tax compliance systems include adequate measures to capture the economic activities of trusts and ensure tax compliance by trusts without resorting to the tenuous approach applied by the North Carolina statute under scrutiny. Trusts have many points of contact with state and federal systems of taxation, and only one such point is at issue

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[16] In the bank regulatory context, a national bank chartered in one state that extends credit to residents of another state, even if such residents were systematically solicited, will not be considered to be "located" in the non-charter state. *Marquette Nat'l Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299, 311 (1978).

in this case – state taxation of accumulated trust income.[17] That the state most naturally positioned to do so does not levy an income tax on a trust neither authorizes another state to do so absent sufficient contacts of its own, nor transmutes the trust from reasonable legacy planning vehicle into an evasive one.

Federal income taxation of trusts is addressed in I.R.C. Subchapter J. The trustee of a trust must report the trust's activities on a fiduciary income tax return unique to the trust, I.R.S. Form 1041, on which the trust reports its income, claims its own deductions and calculates its own, separate federal tax liability, which the trustee must pay. I.R.C. § 6012(b)(4). I.R.C. Section 641(b) provides that "The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual ... [and] ... [t]he tax shall be computed on such taxable income and shall be paid by the fiduciary." That is, a trust avoids none of the stringent reporting (and payment) requirements to which individuals are subject.

States that tax trusts apply similarly stringent requirements to trusts. State systems vary but commonalities exist, as well as consistencies, with the federal system because states have largely mirrored the general approach to taxation adopted by the federal government. Richard D. Pomp, *State & Local Taxation*, at 10-2 (8th Edition 2015) *citing* Clara

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[17] Assets transferred by a living settlor to a discretionary trust are subject to gift tax, or if transferred as a result of the settlor's death, to estate tax; income earned by a trust is uniformly subject to federal income tax.

Penniman, *State Income Taxation*, at 2, tbl. 1 (1980). Like the federal government, states have two opportunities to tax trusts: taxing income accumulated in a trust with constitutionally sufficient contacts to that state, and taxing income distributed out of the trust to an in-state beneficiary. I.R.C. §§ 661(a), 662(a) (illustrating the framework also employed in applicable state statutes).

Like partnerships, and to ensure that all relevant parties (fiduciaries, beneficiaries, and federal and state governments) receive consistent tax information, a trustee must report any distributions made from the trust (and any income and other economic factors carried out from the trust with distributions) on Schedule K-1 to its fiduciary income tax return(s). I.R.S., *Instructions for Form 1041*, at 36 (2018), https://www.irs.gov/pub/irs-pdf/i1041.pdf. This requirement ensures that if trust assets change hands from trustee to beneficiary, all tax attributes are accounted for. Collectively, these reporting requirements and the tax obligations that follow ensure that income does not escape taxation by virtue of being earned by a trust: the timing of that income tax may vary from the result that would have obtained had the income-producing property been held by an individual, and the applicable taxing statutes may also differ, but the trust is transparent to taxing authorities and held to account. Trusts are not tax shelters.

To reverse the North Carolina Supreme Court decision and allow tax on the accumulated but undistributed income of a trust that may never be distributed to a beneficiary in that state would be

inconsistent with the policy and extensive procedures of our federal and state income tax systems.

C. Administrative Burdens Would be Overwhelming if the North Carolina Supreme Court were Overturned

In determining whether the statute passes constitutional muster, the analysis of fundamental fairness required by the Fourteenth Amendment must consider the practicalities of the application of the statute given the "present realities" of trust administration. *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2097 (2018). In practice, the fiduciary management of trust assets would become untenable if the North Carolina statute is found to be constitutional and other states were to amend their statutes to follow suit. Trustees of trusts with large beneficiary classes and geographically mobile beneficiaries would struggle with uncertain tax obligations in multiple states. This lack of clarity would make tax compliance impossible, or lead to gross noncompliance, and upend trust administration in ways that have previously been viewed as undesirable by this Court.[18]

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[18] In the context of bank regulation, this Court has declined to expand the definition of a bank's "location" in recognition of the confusion that would be caused by requiring banks to consider whether they are located in a state based solely on certain contacts with residents of that state. *Marquette Nat'l Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299, 312 (1978).

Under the statute in question, the trustee "responsible for administering the [ ] trust shall pay the tax computed." N.C. GEN. STAT. § 105-160.2 (2017). The State of North Carolina and a minority of other states, Minn. Br., at 4, 6, 9, are asking this court to reach a conclusion that focuses on the beneficiaries, but would enforce the conclusion solely against the trustee. The powers given to a trustee do not allow the trustee to obtain the information necessary to comply with a statute that taxes based on the residency of a discretionary beneficiary. A trustee has the right to obtain information related to a trust's income and applicable deductions.[19] The trustee also has the power to pay such taxes with trust property.[20] However, a trustee does not have the power to compel beneficiaries to provide the information needed to determine their residency. Even if the trustee was able to obtain the addresses of a beneficiary, many individuals are mobile or have multiple residences. Further, the determination of an individual's residency can be a multi-factor test based on objective and subjective

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[19] In fact, it is the trustee's duty to maintain the records that would contain such information. Uniform Trust Code § 810 and North Carolina General Statutes 36C-8-810 state that a trustee "shall keep adequate records of the administration of the trust." See Uniform Trust Code § 810 (Unif. Law Comm'n 2010), N.C. GEN. STAT. § 36C-8-810 (2018).

[20] It is the trustee's duty to file trust tax returns, see I.R.C. § 6012(b)(4), and accordingly the trustee is empowered to pay trust taxes. See Uniform Trust Code § 816(15) (Unif. Law Comm'n 2010) and N.C. GEN. STAT. § 36C-8-816(15) (2018), both granting trustees power to pay from trust property taxes incurred in administration of trust.

factors. As a result, the trustee would still be lacking information necessary to determine residency for tax purposes.

The facts presented in this case are rare in that the current discretionary beneficiaries all resided in a single state for a period of time. It is a far more common situation that beneficiaries are in multiple states and move between states. A trustee may not even know of a beneficiary's place of residence. As beneficiaries are not required to provide a trustee necessary information for the trustee to make a determination on residency, the trustee does not possess the power to practically administer a trust under a state that requires such analysis for compliance by a trustee.

Trustees may even be prohibited from seeking the information necessary in the context of trusts known as "quiet trusts," which authorize the trustee to withhold information from the trust beneficiary or may even prohibit the trustee from providing information to the trust beneficiary. Quiet trusts are permissible under the laws of certain states that permit designated representatives to represent and bind the trust beneficiaries, thus limiting a beneficiary's rights to be informed of the nature of the beneficiary's interest in the trust and limiting a trustee's ability to communicate with beneficiaries of such trusts. Quiet trust statutes are typically found in jurisdictions with advanced and modern trust law. *See* S.D. CODIFIED LAWS § 55-2-13 (2019); 12 DEL. CODE ANN. § 3303 (2019); FLA. STAT. § 736.0306 (2018); ALASKA STAT. § 13.36.080(b) (2018); NEV. REV. STAT. § 163.004 (2019);

N.H. Rev. Stat. Ann. Section 564-B:1-105 (2018); TENN. CODE ANN. § 35-15-813 (2018).

As a practical matter, the trustee also has no control over the residency of its beneficiaries. Unlike this Court's holding in *Wayfair* and other cases addressing state taxation of business entities, the trustee cannot prohibit a beneficiary from moving from one state to another. This is in contrast to a business which may choose to not direct its business towards a state by choosing to not market and sell services or goods to residents of that state. In the case of a trust, any beneficiary can change its residency without the consent or even knowledge of a trustee. Thus, through no action of the trustee or any other beneficiary whose potential future distribution could be reduced by the taxes imposed because of the unilateral action of a single beneficiary.

Trusts with multiple generations of geographically mobile beneficiaries could easily be subject to income tax many times over, on the same dollar earned, in many jurisdictions under statutes such as North Carolina's.[21] Without carefully crafted tax credit mechanisms, this would run afoul of the internally consistent standard refined under the Commerce Clause's "fairly apportioned" rule. *Comptroller of Md. v. Wynne*, 135 S. Ct. 1787, 1809 (2015); *see also Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274

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[21] The Minnesota Attorney General may have filed a brief as amici for Petitioner, but the Minnesota trust taxation statute, Minn. Stat. § 290.01, subd. 7b (2018), is one such statute that could result in multiple taxation if applied to a trust in concert with the North Carolina Statute.

(1977). It is easy to imagine how quickly concurrent taxation may compound if three discretionary beneficiaries live in three separate states with such a statute, and each of those first-generation beneficiaries then has children who all live in different states. While discretionary beneficiaries have no identifiable interest in a trust, the interests of the beneficiaries will be harmed by diminishment of the trust assets administered by the trustee because the same dollar of income can be taxed by many jurisdictions without the appropriate credits necessary to avoid double taxation. In other words, identical application by every state would place interstate commerce at a disadvantage as compared with intrastate commerce. *See Am. Trucking Ass'ns v. Smith*, 545 U.S. 429, 437 (2005); *see also* Peter Spero, *Updated Analysis State Taxation of Out-of-State Trusts,* 46 Estate Planning 20, 25 (April 2019).

The burdens of compliance would be significant, if not insurmountable. Computation of state fiduciary income taxation is not straightforward. A trustee would need to undertake administrative responsibilities bordering on the impossible, which would make many trusts administratively unfeasible to operate.

CONCLUSION

For the foregoing reasons, the judgment of the Supreme Court of North Carolina should be affirmed.

Respectfully submitted,

David M. Lehn
Counsel of Record
Stanley N. Bergman
William J. Kambas
James I. Dougherty
Jeremy A. Mellitz
John A. Farnsworth
Lisa G. Page
Diana M. Hastings
Michelle B. Graham
Louis A. Mezzullo

Withers Bergman LLP
1700 East Putnam Avenue
Suite 400
Greenwich, Connecticut 06870
david.lehn@withersworldwide.com
203-302-4100

Counsel for Amici Curiae

No. 18-457

In the Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST,

Respondent.

On Writ of Certiorari to the Supreme Court of North Carolina

BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

STEVEN P. LEHOTSKY
JONATHAN D. URICK
U.S. Chamber Litigation Center, Inc.
1615 H Street, N.W.
Washington, D.C. 20062

ANDREW J. PINCUS
Counsel of Record
DANIEL E. JONES
Mayer Brown LLP
1999 K Street, N.W.
Washington, D.C. 20006
(202) 263-3000
apincus@mayerbrown.com

Counsel for Amicus Curiae

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INTEREST OF THE *AMICUS CURIAE*[1]

The Chamber of Commerce of the United States of America (the "Chamber") is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country. One of the Chamber's responsibilities is to represent the interests of its members in matters before the courts, Congress, and the Executive Branch. To that end, the Chamber regularly files *amicus curiae* briefs in cases that raise issues of concern to the nation's business community.

Many of the Chamber's members and affiliates regularly are subject to attempted taxation or the purported exercise of adjudicative (personal) jurisdiction, or both, by States other than their States of incorporation or principal places of business. They therefore have a substantial interest in the rules governing the extent to which, consistent with due process, a State may subject nonresident entities to its authority, whether in the form of taxation of the entity's property or requiring the entity to appear in the State's courts.

Petitioner's proposed rule is that a State may tax the *undistributed* income of a nonresident trust based solely on the residence of a contingent benefi-

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[1] Pursuant to Rule 37.6, *amicus* affirms that no counsel for a party authored this brief in whole or in part and that no person other than *amicus*, its members, or its counsel made a monetary contribution to its preparation or submission. Blanket consents from both parties to the filing of *amicus* briefs are on file with the Court.

ciary in the forum State. That rule, if accepted, would represent a dramatic and unwarranted weakening of the fundamental due process protections that this Court has repeatedly recognized. The Chamber therefore has a strong interest in affirmance of the judgment below.

INTRODUCTION AND SUMMARY OF ARGUMENT

The issue in this case is whether a State may tax the worldwide undistributed income of a nonresident trust solely because a contingent trust beneficiary happens to reside in the State, who may—but may not—receive a portion of that income in the future.

Due process requires more before a State may directly exercise its taxing authority over a nonresident entity.

This Court has framed the due process limits on state power somewhat differently depending on the type of authority asserted by the State—subjecting a nonresident to judicial jurisdiction, or taxing a nonresident, or applying the State's law to private parties' disputes.

This case does not require the Court to explore in detail the similarities or differences among these standards, because the Court's precedents make clear that the due process standard for specific judicial jurisdiction provides an appropriate analogy in ascertaining the requirements of the due process test governing a State's taxing power. See *Quill Corp.* v. *North Dakota*, 504 U.S. 298, 306-308 (1992).

Logic leads to the same conclusion. Judicial jurisdiction involves the direct exercise of authority by the State over a nonresident entity. It subjects the

nonresident to potentially onerous financial obligations—the payment of a court judgment—as well as significant ancillary burdens such as requiring the party to appear and defend itself. Taxation is similar: the nonresident is forced to pay a financial exaction to the State, and typically is subject to ancillary audit and administrative burdens.

Indeed, for these reasons, the due process limitations imposed on a State's exercise of judicial jurisdiction and on its taxing authority each focus on fairness and predictability to the nonresident. These similarities make an analogy to judicial jurisdiction decisions wholly appropriate here.

Petitioner argues that judicial jurisdiction decisions are inapposite, appearing to claim that the power to tax should be assessed by reference to the due process standard governing application of a State's law as the rule of decision in non-tax, private disputes. But the Court has repeatedly rejected attempts to equate due process limits on choice-of-law with the due process limits on judicial jurisdiction, holding that a State's interest in applying its laws to a dispute does *not* automatically make its courts a fair forum in which a defendant can be required to appear and defend itself. Petitioner's attempt to distinguish the Court's judicial jurisdiction decisions is therefore unavailing.

Under the correct legal standard, the judgment below must be affirmed. The target of North Carolina's tax, the trustee, has no connection to North Carolina at all. The beneficiary has only a contingent interest—one that may never lead to any payment of trust funds. And, as this Court has recognized, the State cannot attribute the contacts of trust beneficiaries to the trustee in order to obtain jurisdiction

over the trust. See *Hanson* v. *Denckla*, 357 U.S. 235 (1958). Well-established due process principles therefore preclude North Carolina's attempt to tax this trust.

ARGUMENT

I. The Robust Due Process Requirements This Court Has Articulated In The Specific Judicial Jurisdiction Context Provide An Appropriate Analogy In Assessing A State's Authority To Tax A Nonresident.

This Court has addressed the due process limits on a State's power to tax nonresidents in a significant number of decisions. *E.g.*, *Quill*, 504 U.S. at 308-310; *National Bellas Hess, Inc.* v. *Department of Revenue of Ill.*, 386 U.S. 753, 756-757 (1967); *American Oil Co.* v. *Neill*, 380 U.S. 451, 457-459 (1965); *Miller Bros. Co.* v. *Maryland*, 347 U.S. 340, 342 (1954); *Wisconsin* v. *J.C. Penney Co.*, 311 U.S. 435, 444-446 (1940).

Petitioner and respondent discuss those decisions in detail. But they also reference the Court's rulings addressing due process limits on other exercises of state authority.

Thus, respondent points to the Court's specific judicial jurisdiction decisions to bolster its position. Resp. Br. 23-30. Petitioner asserts that those decisions are inapposite in the tax context. Pet. Br. 21 n.9.

The Court has not had occasion to explore in detail how the due process limits on different categories of state authority relate to one another. There is no need to do so in this case, because it is settled that the due process standard for specific personal juris-

diction provides an appropriate analogy for the due process test governing a State's taxing power. And that analogy supports the conclusion that petitioner may not tax the trust here.

A. The Court Has Framed The Due Process Limits On State Authority Somewhat Differently In Different Contexts.

It is a fundamental principle of due process that before a State can directly exercise its authority over a nonresident individual or corporation, there must be an adequate connection between that individual or corporation and the State.

In general terms, whether an exercise of state authority comports with the "traditional notions of fair play and substantial justice" underlying the Due Process Clause turns on whether the defendant has relevant minimum contacts with the forum State. *International Shoe Co.* v. *Washington*, 326 U.S. 310, 316 (1945).

1. To exercise specific judicial jurisdiction over a nonresident defendant, the defendant's "suit-related conduct" must create a "*substantial connection* with the forum State." *Walden* v. *Fiore*, 571 U.S. 277, 284 (2014) (emphasis added). That is, the court must find a substantial relationship between the forum, the defendant's contacts with the forum, and the particular plaintiff's claim, so that it is "reasonable" to require the defendant to appear in the forum to defend against that claim. *World-Wide Volkswagen Corp.* v. *Woodson*, 444 U.S. 286, 292 (1980).

Importantly, specific judicial jurisdiction must be based on the defendant's *own* purposeful contacts with the forum State that give rise to the claim to be adjudicated. This principle was first recognized in

the Court's seminal decision in *International Shoe* and reiterated in every case in which the Court has upheld the exercise of specific judicial jurisdiction. See *Burger King Corp.* v. *Rudzewicz*, 471 U.S. 462, 479 (1985) (noting that the "franchise dispute grew directly out of" the defendant's activities in Florida); *Calder* v. *Jones*, 465 U.S. 783, 789 (1984) (defendants' actions were "expressly aimed at California"); *Keeton* v. *Hustler Magazine, Inc.*, 465 U.S. 770, 780 (1984) (claims "ar[o]se[] out of the very activity being conducted" by the defendant in New Hampshire); *McGee* v. *International Life Ins. Co.*, 355 U.S. 220, 223 (1957) (suit "based on a contract" performed in California); *International Shoe*, 326 U.S. at 320 ("The obligation which [was] here sued upon arose out of th[e] [defendant's] very activities" in Washington).

These requirements for assertion of judicial jurisdiction reflect the fairness concerns animating the Due Process Clause. See, *e.g.*, *Burger King*, 471 U.S. at 464, 472. They provide a "degree of predictability" to defendants, especially corporate defendants, so that they can "structure their primary conduct with some minimum assurance as to where that conduct will and will not render them liable to suit." *World-Wide Volkswagen*, 444 U.S. at 297. And they protect important federalism interests by preventing States from reaching beyond their borders to adjudicate claims over which they "may have little legitimate interest." *Bristol-Myers Squibb Co.* v. *Superior Court of Cal.*, 137 S. Ct. 1783, 1780-1781 (2017) (*BMS*).[2]

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[2] The Court has applied a different, less stringent due process test for determining whether a State may adjudicate the claim of an absent, nonresident member of a plaintiff class. A forum

2. To impose a tax on a nonresident, due process "requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax, and that the income attributed to the State for tax purposes must be rationally related to values connected with the taxing State." *Quill*, 504 U.S. at 306 (quotation marks and citations omitted).

As in the context of judicial jurisdiction, these due process limitations on a State's power to tax promote fairness and predictability. They ensure that a nonresident who lacks sufficient connections to the State will be not be subject to the State's coercive power and that the nonresident has "fair warning that its activity may subject it to the jurisdiction of a foreign sovereign." *Quill*, 504 U.S. at 308 (quotation marks and alterations omitted).

3. The Court has also addressed the due process limits on application of a State's law to provide the rule of decision in a dispute among private parties. In that situation, the State "'must have a significant

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may exercise such jurisdiction "even though that plaintiff may not possess the minimum contacts with the forum which would support personal jurisdiction over a defendant." *Phillips Petroleum Co.* v. *Shutts*, 472 U.S. 797, 811 (1985). All that is required is notice, an opportunity to be heard, an opportunity to opt out, and adequate representation of the interests of the absent class members. *Id.* at 811-812.

It reached this conclusion because nonresident members of a plaintiff class are not subject to the "burdens imposed upon defendants"; for instance, they "need not hire counsel or appear," "are almost never subject to counterclaims or cross-claims, or liability for fees or costs," and "are not subject to coercive or punitive remedies." *Shutts*, 472 U.S. at 810. The lesser standard in *Shutts* thus relates solely to the due process rights of plaintiffs, not defendants. See *BMS*, 137 S. Ct. at 1782-1783.

contact or significant aggregation of contacts, creating state interests, such that choice of its law is neither arbitrary nor fundamentally unfair.'" *Shutts*, 472 U.S. at 818. The State must have these contacts with each plaintiff's claim to ensure that application of the law is not arbitrary and unfair. *Id.* at 821-822. In addition, "[w]hen considering fairness in this context, an important element is the expectation of the parties." *Id.* at 822; see also *Allstate Ins. Co.* v. *Hague*, 449 U.S. 302, 312-313 (1981) (plurality).

* * *

There is no occasion for the Court in this case to address in detail the similarities and differences among the standards that apply in these three different contexts. As we next explain, there can be no doubt that this Court's decisions applying the specific judicial jurisdiction test provide an appropriate analogy for the tax context.

B. Precedent And First Principles Demonstrate The Relevance In The Tax Context Of Decisions Applying The Due Process Standard For Specific Judicial Jurisdiction.

Respondent is correct to invoke decisions involving the due process limits on judicial jurisdiction to demonstrate that application of the North Carolina tax would violate the due process limits on the State's taxation power. That conclusion is supported by this Court's precedent and by the similar interests implicated by subjecting a nonresident to a tax and to judicial jurisdiction.

First, in determining whether application of a state tax to a nonresident comports with due process,

this Court has relied on cases addressing the due process standard for judicial jurisdiction.

The Court's articulation of the due process limitations on tax jurisdiction in *Quill* expressly "[a]pplied" the due process principles from this Court's modern "judicial jurisdiction" cases. 504 U.S. at 307-308 (citing *International Shoe*, 326 U.S. at 316; *Shaffer* v. *Heitner*, 433 U.S. 186, 212 (1977); *Burger King*, 471 U.S. at 476). The standards announced in these cases, the Court explained, should be applied to the requirement for tax jurisdiction—which it phrased in terms analogous to the minimum contacts required for personal jurisdiction: that there be a "definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Id.* at 306 (quotation marks omitted).

Indeed, *International Shoe* itself involved both judicial jurisdiction and tax jurisdiction issues. The Court held that "[t]he activities which establish [International Shoe's] 'presence' subject it alike to taxation by the state and to suit to recover the tax." 326 U.S. at 321.

Second, the burden imposed by application of a state tax closely resembles the heavy burden imposed when a nonresident is forced to appear in court. It is therefore logical that the standard for assessing the minimum contacts required for a State to tax a nonresident would be similar to the test that applies to subjecting a nonresident to judicial jurisdiction.

In both the tax and judicial jurisdiction contexts, the limitations imposed by due process protect nonresident entities from the direct assertion of authority by the State. An adverse judicial judgment sub-

jects the nonresident defendant to the "full powers of the forum State to render judgment *against* it." *Shutts*, 472 U.S. at 808. The defendant

> must generally hire counsel and travel to the forum to defend itself from the plaintiff's claim, or suffer a default judgment. The defendant may be forced to participate in extended and often costly discovery, and will be forced to respond in damages or to comply with some other form of remedy imposed by the court should it lose the suit. The defendant may also face liability for court costs and attorney's fees.

Ibid. Indeed, the "coercive or punitive remedies" that the defendant faces, *id.* at 810, typically take the form of an order to pay money—with the constraints on the amount supplied not by due process limits on jurisdiction but only by the substantive statutory and constitutional law governing the claim—or to take actions that usually impose a significant financial burden on the defendant.

A nonresident faced with a state tax faces similar burdens: the obligation to pay the tax upon pain of criminal prosecution; to submit to potential audit and investigation by the State; and, typically, to proceed through the forum State's administrative or judicial processes (or both) in order to challenge the tax. As the Court held over half a century ago, "seizure of property by the State under pretext of taxation when there is no jurisdiction or power to tax is simple confiscation and a denial of due process of law." *Miller Bros.*, 347 U.S. at 342.

Third, petitioner is wrong in asserting that judicial jurisdiction cases are not relevant. It relies on a

sentence in Justice Scalia's concurring opinion in *Quill* (which was joined by Justices Kennedy and Thomas). See Pet. Br. 21 n.9. The concurrence agreed with the majority's due process holding—overruling *Bellas Hess*, 386 U.S. 753, because it was inconsistent with *International Shoe* and subsequent judicial jurisdiction decisions—but stated: "I do not understand this to mean that the due process standards for adjudicative jurisdiction and those for legislative (or prescriptive) jurisdiction are necessarily identical." *Quill*, 504 U.S. at 319-320.

To begin with, saying the two standards are not "necessarily identical" does not mean that judicial jurisdiction decisions are inapposite when a case involves jurisdiction to tax nonresidents. It simply means that the two tests may not be the same in every single respect.

Certainly Justice Scalia's statement provides no basis for equating the due process standard governing state taxation with the due process test for determining a State's authority to apply non-tax laws to disputes between private parties—which is what petitioner appears to contend by referring generally to "legislative jurisdiction."

That is because the Court's precedents addressing the due process limits on application of a State's non-tax law in the context of a private dispute permit application of a State's law in circumstances in which the State could not require a party to appear as a defendant in its courts.

For example, in *Shaffer*, the Court explained that it had previously "rejected the argument that if a State's law can properly be applied to a dispute, its courts necessarily have jurisdiction over the parties

to that dispute." 433 U.S. at 215. The Court quoted its prior explanation that the State "does not acquire * * * jurisdiction by being the center of gravity of the controversy": when the "issue is personal jurisdiction, not choice of law," it must be "resolved * * * by considering *the acts of the [defendants].*" *Ibid.* (emphasis added and quotation marks omitted) (quoting *Hanson*, 357 U.S. at 254).

Subsequent decisions reaffirm that distinction between judicial jurisdiction and jurisdiction to apply a State's non-tax law. A year after *Shaffer*, the Court explained that California's undeniable "substantial interests in protecting resident children and in facilitating child-support actions on behalf of those children" did not suffice to exercise personal jurisdiction over the appellant, "who lacks any * * * relevant contact with the State, either to defend a child-support suit or to suffer liability by default." *Kulko* v. *Superior Court of Cal.*, 436 U.S. 84, 100-101 (1978) (citing *Shaffer*, 433 U.S. at 215). As a plurality of Justices later summarized, "[t]he Court has recognized that examination of a State's contacts may result in divergent conclusions for jurisdiction and choice-of-law purposes." *Allstate Ins. Co.*, 449 U.S. at 317 n.23 (plurality) (citing *Kulko*, 436 U.S. at 98; *Shaffer*, 433 U.S. at 215); see also *id.* at 320 n.3 (Stevens, J., concurring in the judgment) ("[T]he Court has made it clear over the years that the personal jurisdiction and choice-of-law inquiries are not the same.").

The reason for this distinction is the very different focus of the two standards. The due process limitations on judicial jurisdiction focus on the nonresident *entity*—the defendant—over whom the State is directly exerting authority. As this Court has put it in that context, the "primary concern" is the "burden

on the *defendant*." *BMS*, 137 S. Ct. at 1780 (emphasis added). The federalism concerns are heightened as well: "*even if* the forum State *has a strong interest in applying its law to the controversy*; * * * the Due Process Clause, acting as an instrument of interstate federalism, may sometimes act to divest the State of its power to render a valid judgment." *Id.* at 1780-1781 (emphasis added) (quoting *World-Wide Volkswagen*, 444 U.S. at 294).

In contrast, when the question involves the application of a State's non-tax law, typically to provide the substantive rule of decision in a private dispute, the focus is on the State's interest in the *subject matter* of the dispute. *Shutts*, 472 U.S. at 818 (the State "'must have a significant contact or significant aggregation of contacts, creating state interests, such that choice of its law is neither arbitrary nor fundamentally unfair'").

Taxing power more closely resembles judicial jurisdiction, because it is an assertion of direct state power over the target of the tax, not merely over the particular controversy. See pages 9-10, *supra*.

The key to understanding the sentence in Justice Scalia's opinion lies in his citation of *Asahi Metal Industry Co.* v. *Superior Court of California*, 480 U.S. 102 (1987), and *American Oil*, 380 U.S. 451, just after his statement that he did not interpret the majority's opinion to mean that the standards for judicial and legislative jurisdiction were necessarily identical. Those citations show that his statement was meant to preserve in the context of tax jurisdiction his position in *Asahi* (as part of a plurality) that the "stream of commerce" theory is not a valid ground for judicial jurisdiction. See *Asahi*, 480 U.S. at 108-113 (plurality); see also *American Oil*, 380 U.S. at 457-

458 (rejecting a similar theory in the tax jurisdiction context).

In other words, Justice Scalia wanted to make sure that any subsequent decisions weakening judicial jurisdiction would not spill over to the tax jurisdiction context. As it turns out, the Court never endorsed the "stream of commerce" approach to judicial jurisdiction. See *J. McIntyre Mach., Ltd.* v. *Nicastro*, 564 U.S. 873, 883-885 (2011) (plurality). To the contrary, the Court in recent years has rejected efforts to weaken the due process test for specific judicial jurisdiction, in particular lower courts' unreasonably expansive approaches to jurisdiction. See, *e.g.*, *BMS*, 137 S. Ct. 1773; *Walden*, 571 U.S. 277. Accordingly, Justice Scalia's concurrence offers petitioner no support for applying a weakened due process standard in the tax jurisdiction context.

* * *

In sum, because a State's imposition of a tax on a nonresident imposes burdens similar to those resulting when a nonresident is forced to appear in a State's courts, it is logical for this Court to look to its precedents in the judicial jurisdiction context.

The Court's judicial jurisdiction cases have played an important role in protecting defendants, especially corporate defendants, from expansive and unwarranted exercises of state authority. The Court therefore should take care not to call into question any of its established principles of specific personal jurisdiction.

II. Settled Due Process Principles Prohibit A State From Taxing Undistributed Income Of A Nonresident Trust Based Solely On The Forum Residence Of A Contingent Beneficiary.

The Court's due process precedents require rejection of petitioner's theory that a State may tax the entire undistributed income of a nonresident trust based solely on the residence of a contingent beneficiary. See Am. Coll. of Tr. & Estate Council (ACTEC) Br. 35 ("Taxing the trustee based on the contacts of the beneficiary with the taxing state appears to be at odds with the thrust of the *International Shoe* framework.").

1. The fundamental flaw in petitioner's approach is that it overlooks the absence of any contacts between the trust—which for tax (and many other legal) purposes is represented by the *trustee*, certainly not by a contingent beneficiary—and the State. As the Court explained in *Walden*, the "defendant *himself*" (571 U.S. at 284) (quotation marks omitted) must be the one who "form[s] the necessary connection with the forum State" (*id.* at 285). "[A] defendant's relationship with a plaintiff or third party, standing alone, is an insufficient basis for jurisdiction." *Id.* at 286; accord *BMS*, 137 S. Ct. at 1781.

In *Quill*, the Court therefore reiterated the requirement in the tax jurisdiction context of a "minimum connection * * * between a state and the person, property or transaction it seeks to tax." 504 U.S. at 306 (quoting *Miller Bros.*, 347 U.S. at 344-345). The residence of a contingent beneficiary does not demonstrate any connection between the State and either the taxpayer or the taxed property.

To begin with, there can be no credible argument that the *undistributed* worldwide income of the nonresident trust has any connection to North Carolina. If income is actually distributed to the beneficiary in North Carolina, then North Carolina could tax the beneficiary herself as an individual taxpayer. See Resp. Br. 43, 50-51; ACTEC Br. 9. But that situation is not presented in this case. Nor does this case present the situation in which trust income has its source in the forum State. Moreover, as respondent points out, the contingent beneficiary here may never receive any income from the trust at all. Resp. Br. 3-5.

Next, the taxpayer in this case is undoubtedly the trustee, not the contingent beneficiary. North Carolina taxed the trustee, who paid the tax under protest before bringing suit to challenge its validity. See Resp. Br. 9. That is consistent with the general law of trusts, under which "[a] trust acts and is acted upon only by and through its trustee." ACTEC Br. 5. And the "liability of the Trustee for failure to file a tax return or to make the estimated tax payments is the same as that of an individual." Bogert et al., *The Law of Trusts and Trustees* § 265 (2018); see also Unif. Tr. Code § 816.[3]

Similarly, this Court has recognized that in the context of traditional trusts like the one in this case, the trustee's citizenship "is all that matters" for pur-

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[3] As respondent points out, North Carolina law itself treats the trustee and the trust beneficiary as independent actors and prohibits the State's courts from adjudicating disputes involving trusts that are principally administered elsewhere. Resp. Br. 41-43 & nn.11-12. The administration of a trust is of course carried out by the trustee, not the beneficiary.

poses of diversity jurisdiction, *Americold Realty Tr.* v. *Conagra Foods, Inc.*, 136 S. Ct. 1012, 1016 (2016), and trustees are the "real parties in interest for procedural purposes" in legal matters regarding the trust, *Navarro Sav. Ass'n* v. *Lee*, 446 U.S. 458, 462 (1980).

The conclusion that the trustee's own contacts with the forum State should govern the State's exercise of jurisdiction over the trustee as taxpayer is compelled by the Court's decision in *Hanson*.

The Court there rejected the Florida courts' attempt to exercise jurisdiction over a Delaware trustee based only on the the facts that the settlor later moved there (after creating the trust elsewhere) and that "the settlor and most of the appointees and beneficiaries were domiciled in Florida." 357 U.S. at 254. The problem with that argument was the lack of any relevant contacts by the *trustee* with Florida: the Court explained that "the record discloses no instance in which the trustee performed any acts in Florida." *Id.* at 252. And the Court made clear that "[t]he unilateral activity of those who claim some relationship with a nonresident defendant"—*i.e.*, the choice by the settlor and the beneficiaries to live in the forum State—"cannot satisfy the requirement of contact with the forum State." *Id.* at 253. Simply put, the jurisdictional question "is resolved * * * by considering the acts of the trustee," not other parties that have a relationship to the trust. *Id.* at 253-254.[4]

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[4] *Shaffer* confirms that there is no meaningful difference for due process purposes between the State's assertion of authority over a nonresident and its assertion of authority over the nonresident's property. In *Shaffer*, the Court rejected the assertion of personal jurisdiction based on a Delaware statute "that al-

2. Petitioner points out that the relevant trust was formed at a time when the contingent beneficiary resided in North Carolina. Pet. Br. 7. But the residence of a contingent beneficiary constitutes no contact at all between the taxpayer (the trustee) and the State itself—much less the purposeful availment of a State's laws that is necessary to permit the exercise of the State's taxing authority.

Petitioner's argument that the trustee's administration of the trust for the potential benefit of a North Carolina resident establishes sufficient contacts with the State is the same argument this Court rejected in *Walden*. The Court there held that acts by the defendant affecting the resident of a State are not sufficient to justify the State's exercise of specific judicial jurisdiction over that defendant. Rather, the Court's "'minimum contacts' analysis looks to the defendant's contacts with the forum State itself, not the defendant's contacts with persons who reside there." *Walden*, 571 U.S. at 285; see also *Burger King*, 471 U.S. at 478 ("If the question is whether an individual's contract with an out-of-state party *alone* can automatically establish sufficient minimum contacts in

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low[ed] a court of that State to take jurisdiction of a lawsuit by sequestering any property of the defendant that happens to be located in Delaware." 433 U.S. at 189. The Court rejected that attempt to evade the limitations on *in personam* jurisdiction by creating *in rem* jurisdiction over the sequestered property; instead, the Court held that "*all* assertions of state-court jurisdiction must be evaluated according to the standards set forth in *International Shoe* and its progeny." *Id.* at 212 (emphasis added); accord *Quill*, 504 U.S. at 307. Under those standards, jurisdiction was lacking, because of "the absence of sufficient contacts among the defendants, the litigation, and the State of Delaware." *Shaffer*, 433 U.S. at 189; see also *id.* at 213-214.

the other party's home forum, we believe the answer clearly is that it cannot.").

Here, any contacts by the trustee were directed at the contingent beneficiary, who happened to reside in North Carolina at the time. There simply was no purposeful availment by the trustee of North Carolina's laws or of any market created by those laws. The contingent beneficiary's key relationship to the trust is that she is the settlor's daughter—a relationship that pre-dated, and had nothing to do with, her presence in North Carolina.

Petitioner also points to two meetings that the trustee had with the contingent beneficiary. But those meetings took place in New York and demonstrate no conduct directed by the trustee towards North Carolina—as opposed to, as in *Walden*, towards a person who resides there (and was not even present there at the time of the meetings). Moreover, those "infrequent" meetings, Pet. App. 17a, are the type of "attenuated contacts" that cannot support specific judicial jurisdiction, *Walden*, 571 U.S. at 286 (quotation marks omitted)—and therefore cannot support North Carolina's claim of power to tax the trust.

3. Finally, acceptance of petitioner's jurisdictional arguments would work a dramatic change in the Court's due process jurisprudence that would impose substantial, wholly unjustified burdens on the business community and the federal system.

Permitting a State to tax property or transactions in the absence of substantial purposeful contacts by an entity being taxed would eliminate any predictability regarding the States in which an entity might be subject to taxation. A taxpayer could

not assess his potential exposure to taxes if the types of attenuated contacts advanced by petitioner qualified as minimum contacts with the forum.

Applying tax jurisdiction in such an unpredictable and indiscriminate manner would be unfair to nationwide businesses and irreconcilable with the Due Process Clause. See *Nicastro*, 564 U.S. at 885 (plurality) (explaining that "[j]urisdictional rules should avoid the[] costs [of unpredictability] whenever possible"). Moreover, such an approach would cast doubt on this Court's judicial jurisdiction standard and the critical role it plays in protecting corporate defendants from unjustified exercises of state authority.

Requiring sufficient contacts between the State and the taxpayer also avoids the significant federalism problems that would result from petitioner's approach. Just as due process protects important federalism interests by preventing States from reaching beyond their borders to adjudicate claims over which they "may have little legitimate interest," *BMS*, 137 S. Ct. at 1780-1781, so too does it prevent States from taxing property or transactions without a sufficiently legitimate interest.

To be sure, multiple States may tax income. But here, North Carolina has attempted to tax the *entirety* of a nonresident trust's income based solely on the residence of a contingent beneficiary who may or may not receive a portion of that income in the future. That choice, if permitted, would effectively override the policy judgments of States that have chosen not to tax income at all, or not to tax trust income based on the situs of administration or the residence of the trustee. See Resp. Br. 53-55.

CONCLUSION

The judgment of the Supreme Court of North Carolina should be affirmed.

Respectfully submitted.

STEVEN P. LEHOTSKY
JONATHAN D. URICK
U.S. Chamber Litigation Center, Inc.
1615 H Street, N.W.
Washington, D.C. 20062

ANDREW J. PINCUS
Counsel of Record
DANIEL E. JONES
Mayer Brown LLP
1999 K Street, N.W.
Washington, D.C. 20006
(202) 263-3000
apincus@mayerbrown.com

Counsel for Amicus Curiae

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IN THE

Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,
Petitioner,

v.

THE KIMBERLY RICE KAESTNER 1992 FAMILY TRUST,
Respondent.

On Writ of Certiorari to the Supreme Court of North Carolina

BRIEF OF CONSTITUTIONAL LAW SCHOLARS AS AMICI CURIAE IN SUPPORT OF NEITHER PARTY

ALLAN ERBSEN
UNIVERSITY OF MINNESOTA LAW SCHOOL
229 19th Avenue South
Minneapolis, MN 55455
(612) 626-6632
aerbsen@umn.edu

DARIEN SHANSKE
UC DAVIS SCHOOL OF LAW
400 Mrak Hall Drive
Davis, CA 95616
(530) 752-5860
dshanske@ucdavis.edu

ALAN B. MORRISON
Counsel of Record
THE GEORGE WASHINGTON UNIVERSITY LAW SCHOOL
2000 H Street NW
Washington, DC 20052
(202) 994-7120
abmorrison@law.gwu.edu

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INTEREST OF THE AMICI CURIAE[1]

Amici curiae are law professors who teach and write about how the Due Process and Dormant Commerce Clauses allocate authority among the states and between the states and the federal government. It is their professional opinion that the Dormant Commerce Clause rather than the Due Process Clause of the Fourteenth Amendment is the appropriate source of constitutional standards for resolving this and similar cases. This brief does not take a position on the validity of North Carolina's tax. Instead, amici urge the Court to vacate the state court's judgment, which relied on the Due Process Clause, and remand for further review under the Dormant Commerce Clause.

The three amici are also co-counsel and are listed on the front cover. Their institutional affiliations are provided solely for identification. They have no financial interest in the outcome of this case or other similar matters.

INTRODUCTION AND SUMMARY OF ARGUMENT

The ostensibly narrow question presented in this case obscures a broader constitutional problem. Nominally, this case is about whether North Carolina may tax a trust's undistributed net income because the trust's beneficiary resided in North Carolina

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[1] This brief is filed pursuant to blanket consents provided by all parties. No person other than the amici have authored this brief in whole or in part or made a monetary contribution toward its preparation or submission.

during the relevant tax years. But the broader problem is that many states seek to tax trust income based on the local residence of various persons connected to the trust. These include (1) current beneficiaries, as in this case; (2) the settlor of an inter vivos trust, or the decedent for a testamentary trust; and (3) the trustees. States have also sought to tax the income of trusts that (1) are governed by the laws of the taxing state; (2) hold physical assets within the taxing state; and/or (3) are administered in the taxing state.

The existence of multiple triggers for taxation raises a problem of overlapping jurisdiction that the Due Process Clause is ill-suited to address. For example, if a settlor in State *W* designates a trustee in state *X*, who holds assets in an account in state *Y*, for a beneficiary in State *Z*, four different states might seek to tax the trust's income and might not provide offsetting credits. The Due Process Clause, as opposed to the Dormant Commerce Clause, is a poor fit for sorting out this regulatory overlap for at least three reasons.

First, the Court's due process jurisprudence is designed to identify when a given state may act in isolation, rather than when the overlapping authority of multiple states creates a risk of cumulative burdens. For example, if a transaction affecting several states leads to a civil suit, the Due Process Clause's "minimum contacts" test might permit more than one state to exercise personal jurisdiction, such that the plaintiff can choose between them. This emphasis on the constitutional minimum means that

multiple states can have concurrent power without diminishing each other's authority.

In contrast, taxation of trusts raises a different kind of problem. When a trust has contacts with several states, each state may seek to tax the same income. The issue is not that any of the taxing states lacks a "minimum" connection to the trust. Instead, the issue is that the cumulative effect of taxation by multiple states can burden taxpayers and interstate commerce. Thus, unlike in the personal jurisdiction context, the existence of concurrent tax authority limits each state's discretion to act without regard to other states. An inquiry into "minimum" contacts in this context would distract from the real problem of coordinating concurrent state authority in a federal system.

Second, the Dormant Commerce Clause is a better fit than the Due Process Clause for the coordination problem that this case raises. This Court was faced with a similar choice between the two clauses when it considered whether a state could require an out-of-state retailer to collect use taxes arising from sales to local consumers. Initially, the Court held that both the Due Process and Dormant Commerce Clauses barred such taxes, but later concluded in *Quill Corp. v. North Dakota* that only the Dormant Commerce Clause was an obstacle. *See* 504 U.S. 298, 308, 318 (1992). The Court then overruled *Quill* on the merits of the Dormant Commerce Clause issue in *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2099 (2018).

The Court's preference for Dormant Commerce Clause analysis should extend to the present context of taxes on trusts, in which courts must decide

whether the existence of concurrent authority limits each state's discretion. Current Dormant Commerce Clause jurisprudence provides robust tools for addressing this problem. The test from *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), ensures that states tax only income that has a substantial nexus to the state, that the tax is related to the benefits that the state provides, and that the tax is non-discriminatory and fairly apportioned. Moreover, the undue burden test from *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970), helps balance the interests of states and the trust beneficiaries who will ultimately bear the cost of taxes on undistributed trust income. These tests thus address whether a state may impose any tax at all, and, if so, whether the amount of a tax is appropriate. *See Wayfair*, 138 S. Ct. at 2091, 2099 (noting importance of *Complete Auto* and *Pike* in the context of reviewing state taxes).

If a tax on trust income survives scrutiny under the Dormant Commerce Clause, then minimum contacts analysis would be superfluous. Amici cannot envision a scenario where a minimum contacts inquiry would produce insights that would not also emerge from an inquiry into nexus, relatedness, discrimination, apportionment, and burdens under the Dormant Commerce Clause.

Third, relying on the Dormant Commerce Clause rather than the Due Process Clause would preserve flexibility for Congress to provide comprehensive solutions if it identifies a problem arising from multistate taxation of trust income. In contrast, a ruling on Due Process grounds that North Carolina may not impose the tax at issue here, or that other

states may not tax trusts in other circumstances, would tie Congress's hands in the face of tax avoidance schemes that may undermine reasonable state interests.

A similar problem affected sales and use taxes before *Quill* removed the Due Process barrier to taxing non-resident sellers and thereby empowered Congress to strike the appropriate balance among national, state, and taxpayer interests. When Congress did not act, this Court in *Wayfair* revisited *Quill* and overruled *Quill*'s Commerce Clause holding. Both the majority and dissenting opinions in *Wayfair* noted Congress's continued ability to provide a comprehensive solution, which is not possible if a Due Process holding eliminates some of the options that Congress could otherwise exercise. *See Wayfair*, 138 S. Ct. at 2096–98; *id.* at 2102–05 (Roberts, C.J., dissenting).

In the courts below, respondent objected to North Carolina's tax under both the Due Process and Dormant Commerce Clauses. The trial court held that burdens on commerce provided another basis for setting aside the tax assessment, but the state appellate courts relied only on the Due Process Clause. The Dormant Commerce Clause issue is therefore preserved for review on remand. However, as amici show below, further development of the record is necessary to support a proper Dormant Commerce Clause analysis.

Finally, there is a pending petition for a writ of certiorari in a case in which the Supreme Court of Minnesota ruled that the Due Process Clause barred the state from taxing a trust's income because the sole

trustee was a nonresident. *Fielding v. Comm'r of Revenue*, 916 N.W.2d 323 (Minn. 2018), *petition for cert. filed sub nom Bauerly v. Fielding* (No. 18-664). The court reached that conclusion despite the fact that the settlor and one of the beneficiaries resided in Minnesota and many relevant activities regarding the trust occurred in Minnesota. The petition was distributed for the conference on February 22, 2019 but was not addressed in the ensuing Order List. Amici believe that the present case and the Minnesota case involve closely related issues and that concurrent consideration would assist the Court in identifying a proper framework for addressing taxation of trusts with multistate contacts.

ARGUMENT

THE JUDGMENT BELOW SHOULD BE VACATED, AND THE CASE REMANDED FOR CONSIDERATION UNDER THE DORMANT COMMERCE CLAUSE.

A. State Taxation of Trust Income Relies on Multiple Variables and Often Involves Claims by Several Taxing Jurisdictions.

On its face, this case presents the limited question of whether a state may tax the undistributed income of a trust whose only connection with the taxing state is that the person entitled to the income is a resident of that state. However, North Carolina's tax is merely one variation among a web of state laws that take myriad approaches to taxing income from trusts, as the cases cited in the petition, opposition, and lower court opinions in this case and *Bauerly* illustrate.

The proper taxation of trust income is a complicated matter because trusts often have connections with several states. These include where the settlor or the decedent resided, where the trustees reside, where the trust is administered, where its assets are located, where the beneficiaries reside, where a testamentary trust was probated, and the states identified in the trust's governing documents. *See* Jerome R. Hellerstein et al., *State Taxation* ¶ 20.09[2][b] (3d ed. 2018) ("trusts frequently are considered to be resident in several states simultaneously" and pay taxes to each state without receiving offsetting credits).

Moreover, analysis must account for situations in which the trustee controls the assets of many small trusts, whose beneficiaries and settlors could be anywhere in the United States. *See Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 307–08 (1950). In the days when trusts held real property and/or tangible stock certificates or bonds, considering the location of the trust's physical assets may have been sensible. But with so much now in the cloud or in electronic records, that approach seems archaic. And, for additional complexity, beneficiaries move, trustees change, and there may be more than one of each, not all of whom live in the same state. Thus, a decision from this Court about the validity of North Carolina's tax would impact how courts decide cases addressing a wide variety of state tax statutes governing countless idiosyncratic trusts.

Given the many variables noted above, litigants and judges need guidance about how to assess the validity of state taxes on trust income. Accordingly,

the first question for the Court to address is whether, as the North Carolina courts concluded, the Due Process Clause is the appropriate source of constitutional limits on the states' authority to tax trust income.

B. The Due Process Clause Is Not the Appropriate Source for Rules Governing Challenges to State Taxes on Trust Income.

Two lines of this Court's due process cases are potentially relevant. Both strands posit that the Due Process Clause bars a state from asserting power when the regulated entity or activity lacks a sufficient connection to the state. One set of cases governs efforts to assert adjudicative (personal) jurisdiction, and the other involves efforts to assert legislative (choice of law) jurisdiction. Neither is a good fit for the problem of overlapping taxing authority over trusts with multistate contacts.[2]

First, in the personal jurisdiction context, due process allows states to exercise specific jurisdiction over a defendant whose "minimum contacts" with the forum are related to the pending suit. *BNSF Ry. Co.*

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[2] Petitioner identifies "elements" of a due process test for taxes on trusts. Pet. Br. 15 (citing *Quill*). However, the case on which petitioner relies explicitly adopted "[c]omparable reasoning" to the Court's personal jurisdiction decisions, which begs the question that amici address of whether the "minimum contacts" test has been used in a context for which it is not suited. *Quill*, 504 U.S. at 307–08 (citing *Int'l Shoe Co. v. Washington*, 326 U.S. 310 (1945)); *see also Nw. States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 465 (1959) (citing *Shoe* while analyzing a state tax on an out-of-state corporation's income).

v. Tyrrell, 137 S. Ct. 1549, 1558 (2017) (quoting *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945)). The problem with this test in the trust context is that several states can have contacts with the same trust and efforts to characterize some contacts as less than "minimum" would often be arbitrary.

For example, consider a hypothetical testamentary trust created by a decedent domiciled at the time of death in State *W*. The trustee resides in state *X* and holds property in an account in state *Y* for a beneficiary in State *Z*. Each state claims an interest in taxing the trust based on its connection to important actors, assets, or activities. In all four contexts, the trust's contacts are "purposeful" and the trust enjoys the "benefits and protections" of the taxing state's laws. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475–76 (1985) (citations omitted). Indeed, to the extent that benefits are relevant, each state can invoke the basic protections provided to every resident, whether a settlor, beneficiary, or trustee. Either all four states have minimum contacts and provide relevant benefits, or a court that fears the consequences of that conclusion would arbitrarily decide that some contacts are less-than-minimum or that some benefits count less than others.

The present case and the pending petition from Minnesota in *Bauerly*, *supra*, illustrate the unhelpful nature of the minimum contacts approach. The North Carolina court held that the beneficiary's residence is insufficient, and the Minnesota court held that the settlor's residence is also insufficient. Both cases appear to converge on a view that the location of the trustee is a critical predicate for taxation. *See*

Kimberley Rice Kaestner 1992 Family Tr. v. North Carolina Dep't of Revenue, 814 S.E.2d 43, 50–51 (N.C. 2018) (emphasizing that the trustees administered the trust in New York); *Fielding*, 916 N.W.2d at 333 (emphasizing that "trust administration activities by the Trustees occurred in states other than Minnesota"). Granting the trustee's home state a monopoly on taxation of undistributed trust income would revive the formality that this Court eschewed when it rejected "the mere mechanical operation of locating at a single place, and there taxing, every legal interest growing out of all the complex legal relationships which may be entered into between persons." *Curry v. McCanless*, 307 U.S. 357, 373 (1939). If a trustee implements directives of a nonresident for the benefit of a nonresident, such that the trustee's home state is merely a conduit of assets between other states, then there is no good reason to invoke due process formalities instead of a more functional approach that better serves the relevant national, state, and taxpayer interests.

Second, in the context of legislative jurisdiction, the issue here is similar to the choice of law issue in *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985). The Court in *Shutts* held that the Due Process Clause precluded Kansas courts from applying Kansas law to the claims of all members of a class, where more than 99% of the property at issue was located outside of Kansas and 97% of the class members were not Kansas residents. *Id.* at 815, 820–23. In reaching that conclusion, the Court held that the Due Process Clause provides only "modest restrictions on the application of forum law" and grants considerable leeway for "more than one jurisdiction's laws" to

apply, but that Kansas had gone too far. *Id.* at 818, 822; *see also Allstate Ins. Co. v. Hague*, 449 U.S. 302, 314 (1981) (plurality opinion) (noting that the Due Process Clause permits a state to apply its law in circumstances when affected actors might "use state services and amenities and may call upon state facilities").

Applying *Shutts* and *Allstate* to the present case would still allow North Carolina to impose its tax because it had a close connection to the trust during the relevant tax years, when the trust existed for the sole purpose of benefiting a North Carolina resident and her children. Again, the real problem in cases like this one and *Bauerly* is not that trusts will often lack relevant contacts with a taxing state, but that trusts will often have relevant contacts with many states, raising the possibility of double taxation or other burdens on interstate commerce.[3]

The issue in personal jurisdiction and choice of law cases is whether a given state has a minimum connection to a dispute. Often, several states can clear that low bar, which is not troubling in the context of current jurisprudence governing adjudicative and legislative jurisdiction. For example, suppose that a resident of Minnesota enters into a contract with a resident of North Carolina and then sues for breach in a Minnesota court under Minnesota law. The fact that North Carolina might also have been able to provide

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[3] The Court has held that double taxation of trust income does not violate the Due Process Clause, *see Curry v. McCanless*, 307 U.S. 357, 372–74 (1939), but may violate the Commerce Clause, *see Comptroller of the Treasury v. Wynne*, 135 S. Ct. 1787, 1798–800 (2015).

a forum and apply its law does not undermine the "minimum" nature of Minnesota's contacts. Thus, there is no bar against "double personal jurisdiction" or "double choice of law." But "double taxation" is potentially a problem when states have concurrent power to tax the same trust income. The Due Process Clause's emphasis on minimum connections does not provide an appropriate mechanism to address overlapping state authority.

Finally, Due Process Clause rulings limit Congress's options, while Dormant Commerce Clause rulings preserve Congress's discretion. Given the complexity of the policy issues governing taxation of trusts, Congress should have an opportunity, if it chooses, to create a national solution on a clean slate. Piecemeal due process decisions that preclude states from taxing trust income in some circumstances would frustrate Congress's ability to craft a coherent solution to a national problem affecting a huge volume of highly mobile assets. The availability of the Dormant Commerce Clause means that there is no reason for this Court to tie Congress's hands with a due process ruling. *See infra* at 18–19 (noting examples of how Congress has regulated multistate taxation).

In sum, existing doctrine under the Due Process Clause does not offer a promising framework for sorting through the complexities of overlapping state authority to tax trust income. The Court could try to develop a new jurisprudence of interstate trust taxation under the Due Process Clause, but there is no reason to do that because, as the next section shows, current Dormant Commerce Clause doctrine

provides an established approach to thinking about systematic federalism problems involving concurrent authority. Indeed, the Dormant Commerce Clause already provides the framework for how states tax other complicated interstate business entities, including corporations and partnerships, limited liability companies, real estate investment trusts, and other multistate businesses.

C. The Dormant Commerce Clause Should Govern the Constitutionality of State Taxes on Trust Income.

The Court's "minimum contacts" jurisprudence primarily addresses formal connections between the defendant and the state seeking to adjudicate a specific controversy. In contrast, this case is primarily about practical economic matters, which is the focus of the Commerce Clause. Most of the trusts that are likely to catch the attention of revenue departments have multi-million dollar corpuses and are often managed by banks and other large financial institutions. Indeed, in this case, a $13 million trust sought a $1.28 million tax refund for the four years at issue. Pet. at 6.

This Court has developed tools for applying the Dormant Commerce Clause to cases in which the primary issue is whether and how a state may tax a particular set of actors or transactions. Indeed, the Court has addressed the question of whether the Due Process Clause or the Dormant Commerce Clause is the preferred method of analysis in an analogous context: whether a state may require an out of state seller, which sends its products to a resident of that state, to collect the sales tax that the resident owes.

In answering that question, the Court considered both the Due Process and Dormant Commerce Clauses and eventually preferred the latter.[4]

Initially, in *Nat'l Bellas Hess, Inc. v. Dep't of Revenue*, the Court ruled that both Clauses precluded the state from imposing a collection requirement on the seller. *See* 386 U.S. 753, 756–60 (1967). Twenty-five years later, in *Quill Corp. v. North Dakota*, the Court rejected *Bellas Hess*'s due process holding but preserved its Commerce Clause ruling. *See* 504 U.S. 298, 308, 318 (1992). The Court acknowledged that the two grounds overlapped in certain respects, but concluded that the Commerce Clause set a higher and more nuanced bar than the Due Process Clause. *See id.* at 312–13. Finally, in *South Dakota v. Wayfair, Inc.*, the Court overruled *Quill*, taking a functional approach under the Dormant Commerce Clause that rejects "anachronistic formalisms." 138 S. Ct. 2080, 2095 (2018).[5]

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[4] Our analysis of the role of the two clauses broadly follows that of the leading treatise on state taxation. *See* Jerome R. Hellerstein et al., *State Taxation* ¶ 20.09[2][b] (3d ed. 2018) ("[We do not] believe . . . that there is any basis for construing the Due Process Clause to preclude state taxation of accumulated trust income on the basis of the residence of the trustee, the trust beneficiaries, or the place where the trust is administered.... But that is not—or should not be—the end of the inquiry. Even if the risk of multiple taxation of accumulated trust income raises no due process issue, it does create Commerce Clause concerns.").

[5] Because cases applying the Due Process and Commerce Clauses to state taxes have over time shared common features and assumptions, it is not surprising that state courts sometimes follow the due process path when the Dormant Commerce Clause path would be more appropriate. *See* Allan Erbsen, Wayfair *Undermines* Nicastro*: The Constitutional Connection Between*

Another recent decision addressing a state income tax invoked the Dormant Commerce Clause to set aside a Maryland law that denied its residents who earned income outside the state full credit for taxes paid to other states. *See Comptroller of the Treasury v. Wynne*, 135 S. Ct. 1787 (2015). The majority concluded that the Commerce Clause prevented discriminatory double taxation that the Due Process Clause would have tolerated. *See id.* at 1798–2000. While four Justices dissented from the invalidation of Maryland's denial of credits, only Justices Scalia and Thomas objected to analyzing the issue under the Dormant Commerce Clause and none suggested that the Due Process Clause would forbid what the Dormant Commerce Clause would allow. *See id.* at 1808 (Scalia, J., dissenting); 1811 (Thomas, J., dissenting); 1813–14 (Ginsburg, J., dissenting).[6]

The starting point for applying the Dormant Commerce Clause to situations involving state taxation of interstate income is the four-prong approach articulated in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). "The Court will sustain a tax so long as it (1) applies to an activity with a substantial nexus with the taxing State, (2) is fairly

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State Tax Authority and Personal Jurisdiction, 128 YALE L.J.F. 724 (2019).

[6] *Wynne* is also notable for this Court's careful decision to avoid dictating a specific approach to taxation of interstate income. *See, e.g.*, *Wynne*, 135 S. Ct. at 1806 ("while Maryland could cure the problem with its current system by granting a credit for taxes paid to other States, we do not foreclose the possibility that it could comply with the Commerce Clause in some other way"). A Due Process holding that categorically forbids taxation of a resident beneficiary would create the inflexible constraints on legislative discretion that the Court sought to avoid in *Wynne*.

apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services the State provides." *Wayfair*, 138 S. Ct. at 2019 (citing *Complete Auto*). This inquiry focuses on "structural concerns about the effects of state regulation on the national economy." *Quill*, 504 U.S. at 312.

In the present context, the "substantial nexus" and "relatedness" prongs determine whether a state has a foundation for asserting its authority to tax trust income and can justify the amount of the tax. An "interstate business must have a substantial nexus with the State before *any* tax may be levied on it" and "the *measure* of the tax must be reasonably related to the extent of the contact." *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626 (1981). The nexus and relatedness prongs thus apply even when there is no double-taxation, such that the only question is whether a state has exceeded limits on its authority to impose a tax.

The fair apportionment prong helps courts decide how to allocate authority to tax when trust income has a substantial nexus with more than one state. The Court has explained that the fair apportionment inquiry has two parts:

> The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business's income being taxed. The second and more difficult requirement is what might be called external

> consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.

Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 169 (1983). This rubric guides how states apportion the nationwide income of businesses with substantial activity in more than one state. The all-or-nothing approach of due process cases does not permit this nuanced analysis.

Another Dormant Commerce Clause case, *Pike v. Bruce Church, Inc.* 397 U.S. 137 (1970), offers further insight into how to approach state taxes on trusts. *Pike* applies when a nondiscriminatory law allegedly places an unreasonable burden on interstate commerce:

> Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

Id. at 142 (citation omitted). *Pike* involved a challenge to a regulation rather than a tax. However, as Justice Scalia observed in *Quill*, "[i]t is difficult to discern any principled basis for distinguishing between

jurisdiction to regulate and jurisdiction to tax." *Quill*, 504 U.S. at 319 (Scalia, J., concurring in part and in the judgment). Not surprisingly, the Court in *Wayfair* recognized that *Pike* provides a judicial backstop if a state enacts laws that are much more burdensome than those of South Dakota. *See Wayfair*, 138 S. Ct. at 2091, 2099. The Court's concerns about burdens in *Wayfair* are also relevant in the context of trusts, as duplicative taxation of the same income can create an unconstitutional burden. *Pike* thus provides protection against unreasonable state taxation of trusts.

Dormant Commerce Clause analysis would also avoid the rigidity that appears in cases such as this one and *Bauerly*. As the Court made clear in *Wayfair*, courts in Dormant Commerce Clause cases "should not rely on anachronistic formalisms" but should instead utilize "basic principles of the Court's Commerce Clause jurisprudence [which] are grounded in functional, marketplace dynamics." 138 S. Ct. at 2095. Moreover, a functional Commerce Clause analysis, in contrast to the formalistic Due Process approach, is more likely to make reasonable adjustments when taxpayers try to game the system by manipulating their contacts with states (for example, by changing trustees or relocating the place of the trust's administration without altering the trust's purpose).

Although Congress did not act in response to the ruling in *Quill*, Congress has acted to establish uniform rules in other interstate tax contexts. Most relevant for current purposes is Section 117(b) of the Mobile Telecommunications Sourcing Act of 2000

(MTSA), which established a uniform rule for state and local taxation of mobile telephone calls. *See* Pub. L. 106-252, 114 Stat. 626, *codified at* 4 U.S.C. § 117(b). The MTSA was in large part a response to this Court's decision in *Goldberg v. Sweet*, 488 U.S. 252 (1989), which provided a narrow nexus test that was overtaken by the rapid development of mobile phones. Both the states and commercial interests supported sensible national standards, and the resulting federal law has won praise as "a poster child for horizontal Federal-State tax coordination at its best." *Tax Reform: What It Means for State and Local Tax and Fiscal Policy: Hearing Before the S. Comm. on Fin.*, 112th Cong. 9 (2012) (statement of Professor Walter Hellerstein).[7]

Preserving flexibility for Congress is especially important in the context of taxes on trusts. Given the many variations in how states attempt to tax trust income, it might take this Court many years and many cases to sort through the possibilities, if it ever does. Meanwhile, settlors, trustees, beneficiaries, and their advisors need to know the tax consequences of creating, operating, and modifying a trust. Lack of clarity and predictability is an obstacle to effective planning. And to the extent that either the current residence of a beneficiary, the work address of one or more trustees, or the physical or virtual location of assets is found to be relevant, not knowing the consequences of relocations and replacements can be very unsettling. The ability of Congress to provide

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[7] Another example is that Congress has permitted states to tax interstate motor fuels only in conformity with the International Fuel Tax Agreement. *See* 49 U.S.C. § 31705(b).

clarity and stability by addressing the whole area of state taxation of trusts is a major advantage of relying on the Dormant Commerce Clause rather than the Due Process Clause.

In sum, there is no role for the minimum contacts test to fill that the Dormant Commerce Clause does not already fill with more nuance and closer attention to the relevant constitutional values. If a tax survives scrutiny under *Complete Auto* and *Pike*—i.e., if there is a substantial nexus, relatedness, fair apportionment, no discrimination, and no undue burden—then minimum contacts analysis would be a superfluous distraction that would potentially tie Congress's hands.

D. The Court Should Remand this Case for Full Consideration of Respondent's Dormant Commerce Clause Claim.

The question presented in the petition is "Does the Due Process Clause prohibit states from taxing trusts based on trust beneficiaries' in-state residency?" Amici urge the Court to answer this question by ruling that the Dormant Commerce Clause, rather than the Due Process Clause, is the relevant source of limits on state authority to tax trust income.

However, this Court should not apply the Dormant Commerce Clause on the present record. The state appellate courts did not do so, the petition did not request it, the parties presumably will not brief the issue in depth, and the record is incomplete. The Court should instead remand for further proceedings

to address respondent's Dormant Commerce Clause arguments, which were preserved on appeal.[8]

Amici do not propose a particular outcome on remand. Instead, we highlight a few issues that might be relevant and that further illustrate how the Dormant Commerce Clause supplies an appropriate framework for analyzing state taxation of trusts.

First, while the Constitution clearly allows North Carolina to tax income *distributed* to a local trust beneficiary, *see Guaranty Trust Co. v. Virginia*, 305 U.S. 19, 23 (1938), the challenged tax on *undistributed* income raises a more difficult question. For example, suppose that a beneficiary moves out of the state after the state uses the beneficiary's residence as a basis for taxing undistributed income (as happened here, Br. in Opp. 4). The departure might in hindsight either confirm that the tax was necessary, because waiting for distribution would have deprived the state of revenue, or suggest that the tax was premature.

Second, mobility creates complications for both trusts and states. Trustees relocate or are replaced, current beneficiaries relocate or yield to future beneficiaries, and assets are bought, sold, and transferred among custodians. Trusts therefore cannot easily predict who will tax them in the future, and states cannot easily predict the duration of their authority over a particular trust. Analysis of

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[8] *See* Br. of Plaintiff-Appellee, at 6–7, *Kimberley Rice Kaestner 1992 Family Trust v. N.C. Dep't of Revenue*, 814 S.E.2d 43 (N.C. 2018) (No. 307PA15-2).

constitutional limits on taxation should consider the implications of this uncertainty.

Third, the record should be developed to determine whether there is a risk of multiple taxation in this case and, if so, on what basis. Specifically, the trial court, which briefly considered Dormant Commerce Clause issues, did not consider whether the North Carolina tax system is internally consistent, meaning whether "if applied by every jurisdiction, it would result in no more than all of the unitary business's income being taxed." *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983); *see also Kimberley Rice Kaestner 1992 Family Tr. v. North Carolina Dep't of Revenue*, No. 12 CVS 8740, 2015 WL 1880607, at *9 (N.C. Super. Ct. Apr. 23, 2015) ("Because . . . Plaintiff fails to satisfy the first and fourth prongs of *Complete Auto*, the Court need not address prongs two and three of that test."). Relevant questions include what kind of credits, if any, North Carolina might provide for taxes paid to other states and on what other basis, if any, North Carolina taxes the income of trusts.

Fourth, a tax that satisfies all four prongs of *Complete Auto* might still be administered in a way that imposes an "undue burden" on interstate commerce. *Wayfair*, 138 S. Ct. at 2098. Proceedings on remand should therefore address the practical effects of North Carolina's tax.

* * *

The relevant facts are all readily learnable, but they have not been the focus of this litigation to date. They also have not been analyzed under the

appropriate Dormant Commerce Clause precedents, such as *Complete Auto*, *Pike*, and the recent June, 2018 decision in *Wayfair*. A remand to the North Carolina courts would enable the current parties, and perhaps other interested organizations or states, to offer evidence and make legal arguments that can inform the state court of the relevant Dormant Commerce Clause considerations.

CONCLUSION

For the foregoing reasons, the Court should vacate the judgment below and remand the case to the North Carolina courts for consideration of respondent's Dormant Commerce Clause claim.

Respectfully submitted,

ALLAN ERBSEN
UNIVERSITY OF MINNESOTA
LAW SCHOOL
229 19th Avenue South
Minneapolis, MN 55455
(612) 626-6632
aerbsen@umn.edu

ALAN B. MORRISON
Counsel of Record
THE GEORGE WASHINGTON
UNIVERSITY LAW SCHOOL
2000 H Street NW
Washington, DC 20052
(202) 994-7120
abmorrison@law.gwu.edu

DARIEN SHANSKE
UC DAVIS SCHOOL OF LAW
400 Mrak Hall Drive
Davis, CA 95616
(530) 752-5860
dshanske@ucdavis.edu

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No. 18-457

IN THE

Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,
Petitioner,

v.

THE KIMBERLY RICE KAESTNER 1992 FAMILY TRUST,
Respondent.

On Petition for *Writ of Certiorari* to the Supreme Court of North Carolina

BRIEF *AMICUS CURIAE* OF COUNCIL ON STATE TAXATION IN SUPPORT OF RESPONDENT

FREDRICK NICELY
Counsel of Record
NIKKI DOBAY
KARL FRIEDEN
DAVID SAWYER
COUNCIL ON STATE TAXATION
122 C St. N.W., Suite 330
Washington, D.C. 20001
(202) 484-5222
fnicely@cost.org

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WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

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INTEREST OF *AMICUS CURIAE*

The Council On State Taxation ("COST") is a nonprofit trade association based in Washington, D.C. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce. Today COST has grown to an independent membership of approximately 550 major corporations engaged in interstate and international business.[1] COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multi-jurisdictional business entities.

COST members often have limited presence in a state and what constitutes sufficient "minimum contacts," *see Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992) citing *Miller Brothers Co. v. Maryland*, 347 U.S. 340 (1954) and *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978), for a state to assert jurisdiction over a taxpayer not domiciled in the state is of upmost importance. An important part of an equitable and nondiscriminatory tax system is predictability and stability. Taxpayers, as well as state and local governments seeking revenue from the taxes and fees they impose, need clear guidance from the Court as to when taxpayers not domiciled in a state can be subject to state and local taxation under the U.S. Constitution's Due Process Clause.[2]

COST has a history of submitting *amicus* briefs to this Court when it considers state and local tax issues.

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[1] No counsel for a party authored this brief in whole or in part, and no person or entity other than *amicus curiae* has made a monetary contribution to the preparation or submission of this brief. Both parties provided blanket consent to file *amicus curiae* briefs with the Clerk of this Court.

[2] U.S. Const. amend. XIV.

Most recently, COST submitted *amicus* briefs in three significant state tax cases decided by the Court during the 2014 term: *Comptroller of the Treasury of Maryland v. Wynne*, 135 S. Ct. 1787 (2015); *Alabama Dep't of Revenue v. CSX Transp., Inc.*, 135 S. Ct. 1136 (2015); and *Direct Marketing Association v. Brohl*, 135 S. Ct. 1124 (2015). Further, COST regularly submits *amicus* briefs at the petition phase before this Court. *See, e.g.*, *Nextel Communications of the Mid-Atlantic, Inc. v. Commonwealth of Pennsylvania, Dep't of Rev.*, 171 A.3d 682 (Pa. 2017), *cert. denied* 138 S. Ct. 2635 (2018) and *Gillette Commercial Operations N. Am. & Subsidiaries v. Dep't of Treasury*, 878 N.W.2d 891 (Mich. Ct. App. 2015), *appl. for leave to appeal denied*, 880 N.W.2d. 230 (Mich. 2016), *cert. denied*, 137 S. Ct. 2157 (2017). As a long-standing representative of large multijurisdictional taxpayers, COST is uniquely positioned to provide this Court with background information and reasons why state tax systems need structure to ensure they are fair and pass muster under the U.S. Constitution's Due Process Clause. COST members have significant activities and operations in all fifty states and are directly impacted when a state court fails to correctly apply the principles required by this Court's Due Process Clause decisions.

SUMMARY OF THE ARGUMENT

The importance of this case for all taxpayers has been heightened by this Court's recent decision in *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018). As the majority of the Court noted, "[w]hen considering whether a State may levy a tax, Due Process and Commerce Clause standards may not be identical or coterminous, but there are significant parallels." *Id.* at 2093. This Court in *Wayfair* specifically determined

that the physical presence standard had outlived its usefulness for determining substantial nexus under the Commerce Clause for sales and use tax purposes and replaced the physical presence test with an economic and virtual presence standard. *Id.* at 2099. Although the Court noted that certain features of South Dakota's laws (*i.e.*, threshold requirements, no retroactive application and South Dakota's participation in the Streamlined Sales and Use Tax Agreement) would satisfy substantial nexus under the Commerce Clause, the Court did not opine on what specific in-state activities or contacts are sufficient to meet the Due Process Clause requirements. Further, the Court specifically noted in *Wayfair* that relief for *de minimis* contacts was an issue not before it in that case. *Id.* at 2099. As a result, this case provides the ideal opportunity for the Court to clarify what contacts are, or are not, sufficient to meet the Due Process Clause's "minimum connections" requirement. This Court can assist both taxpayers and state and local governments by providing guidance on what contacts an entity must have with a state or locality to be sufficient (or not sufficient) for the government to assert its taxing authority.

The jurisdiction of a state or locality to impose a tax should be constrained by whether an entity is domiciled in such state or locality. *Amicus* will highlight the differences between domiciled and non-domiciled entities and why this distinction is important. An entity domiciled in a state would be subject to that government's general taxing powers versus a non-domiciled entity that is merely doing business in that jurisdiction, which may be subject only to the specific taxing

powers of the government.[3] This Court's articulation of a clear line of authority for a state to impose its taxing powers based on the state having general tax jurisdiction versus specific tax jurisdiction would benefit taxpayers and the state and local taxing jurisdictions alike, providing clear guidance on the Due Process Clause limits on state and local governments to impose taxes and raise revenue.

Fortunately, this Court in 2011 and 2014 issued four decisions that provided guidance on the Due Process Clause that are instructive. *Amicus* will address these four significant cases below, which include: *J. McIntyre Mach., Ltd. v. Nicastro*, 564 U.S. 873 (2011), *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 564 U.S. 915 (2011), *Daimler AG v. Bauman*, 571 U.S. 117 (2014), and *Walden v. Fiore*, 571 U.S. 277 (2014). These cases provide a framework that addresses not only the issue directly before the Court—when can a state impose an income tax on a trust—but can also provide comprehensive guidance as to the Due Process Clause limitations on state imposition of other types of taxes where an entity is not domiciled in the state.

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[3] Addressing jurisdictional issues post-*Wayfair*, *see* Walter Hellerstein and Andrew Appleby, *Substantive and Enforcement Jurisdiction in a Post-Wayfair World*, 90 State Tax Notes 283 (2018).

ARGUMENT

I. THE DUE PROCESS CLAUSE REQUIRES DIFFERENT STANDARDS FOR IMPOSING TAX BASED ON GENERAL JURISDICTION VERSUS SPECIFIC JURISDICTION.

An entity, whether an individual, partnership, or a corporation can be subject to various taxes in multiple locations; however, an entity should not be subject to all the taxes of a specific jurisdiction without any limitation.[4] The ability of a jurisdiction to impose the full extent of its taxing authority upon an entity is similar to a state having "general jurisdiction" over an entity for purposes of being subject to litigation within the state. This Court has addressed the issue of general jurisdiction for these purposes on numerous occasions and has determined those cases are relevant for purposes of determining when an entity has a sufficient connection with a taxing jurisdiction for purposes of the Due Process Clause. *See International Shoe Co. v. Washington*, 326 U.S. 310 (1945) and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

General jurisdiction for taxes should follow the location where an entity is domiciled. For example, an individual or other entity engaged in business in ten states should only be subject to the general taxing authority of the state or locality in which the individual or entity is personally or commercially domiciled. That state, and that state alone, is the only jurisdiction that can impose its taxes on such an entity,

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[4] While it may appear difficult to determine the domicile for some types of entities, the Court provided guidance on where a corporation is domiciled in *Hertz Corp. v. Friend*, 559 U.S. 77 (2010).

regardless of whether the activity directly occurred in the state.

However, a state with general jurisdiction is constrained as to how it can tax non-domiciliary entities that are not subject to the state's general jurisdiction. The state's tax scheme must be consistent and cannot be structured in a way that subjects a taxpayer's income to tax more than once if every other state imposed a similar tax. *See Comptroller of the Treasury v. Wynne*, 135 S. Ct. 1787 (2015).[5] In *Wynne*, the state law failed to give full credit for similar taxes the taxpayer paid to other states.

A state (or local jurisdiction) where an entity is not domiciled may also be able to impose a specific tax on that entity, but only if the entity's activities conducted in the taxing state rise to a level sufficient to meet the standards of the Due Process Clause (*i.e.*, specific jurisdiction). To illustrate this, consider a state's corporate income tax. States are required to allow an entity to apportion the business income earned by an entity as a measurement of its business activity in the state, and to allocate the nonbusiness income,[6]

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[5] This does not prevent double taxation because other states can have different apportionment and allocation schemes; however, it does prevent a state from asserting a full tax against entities domiciled in the state while also imposing a tax on entities not domiciled in the state, mitigating the imposition of discriminatory taxation.

[6] Nonbusiness income is income not directly related to the business operations of an entity (*e.g.*, certain investment income) which has been addressed by this Court in *MeadWestvaco Corp. v. Illinois Dep't of Revenue*, 553 U.S. 16 (2008); *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992); and *F.W. Woolworth Co. v. Taxation & Revenue*, 458 U.S. 354 (1982).

generally to the State where the entity is domiciled.[7] An entity's domicile is less important for purposes of business income, because a state with general jurisdiction apportions that income to satisfy internal consistency requirements. Conversely, non-business income is generally allocated to the state of the entity's domicile.[8]

For the trust at issue in this case, North Carolina does not have general jurisdiction for taxation purposes because the trust is a separate legal entity from the trust's beneficiary(s). With no general jurisdiction, North Carolina is limited to taxing such a trust based on the specific activity conducted by the trust in the State. Unlike asserting jurisdiction over rental income received from rental properties in North Carolina, which is subject to the State's specific jurisdiction, North Carolina is relying solely on the location of a beneficiary to the trust, and not the activity conducted by the trust which is generating taxable income. This is clearly insufficient for Due Process Clause purposes.

A. General Tax Jurisdiction Must Be Limited To An Entity's Domicile.

Although not directly related to the imposition of a tax, this Court has limited many states' broad long-arm statutes asserting general jurisdiction pursuant

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[7] Some states have differences in the allocation of nonbusiness property, such real estate which may be allocated based on the property's location rather than an entity's domicile. The tax would still need to be internally consistent, regardless.

[8] "The State distinguishes between business income, which it apportions between it and other States for tax purposes, and nonbusiness income, which it generally allocates to a single State on the basis of commercial domicile." *F.W. Woolworth Co. v. Taxation & Revenue*, 458 U.S. 354, 357 (1982).

to the Due Process Clause. In another case involving North Carolina, *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 564 U.S. 915 (2011), this Court specifically reined in the State when it attempted to assert general jurisdiction because the defendant's connection with the State was too limited. While the case dealt with a tragic bus accident involving a North Carolina youth playing soccer in France, this Court unanimously held the petitioners lacked "continuous and systematic general business contacts" requisite for North Carolina to entertain a suit that was unrelated to the contacts the petitioners had with the State. *Id.* at 928 (citing *Helicopteros Nacionales de Columbia, S.A. v. Hall*, 466 U.S. 408, 416 (1984)).

The North Carolina Department of Revenue appears to, yet again, be pushing the boundaries of the State's jurisdictional reach over non-domiciled entities, and in doing so, is relying on the "stream-of-commerce" theory that this Court rejected in *Goodyear Dunlop*. *Id.* at 927. The flow of income from a trust may ultimately be to its beneficiaries, but the mere fact a trust has a beneficiary in the State does not equate to the trust being domiciled in that State. "Single or occasional" acts of a trustee having contacts with a beneficiary in North Carolina are insufficient for the State to assert general taxing jurisdiction over the trust based on a beneficiary's domicile, just as they were deficient in *Goodyear Dunlop*. *Id.* at 924.

A trust is a separate legal entity from its beneficiaries. A trust's contacts with the forum state and whether the contacts are on a continuous and systematic basis are the most relevant factors for determining the appropriate forum jurisdiction to impose a tax, not the status of one or more beneficiaries of a trust who could be located anywhere in the world. Where the trust

conducts business is a "purposeful activity" of the trust; the domicile of the beneficiaries is not, however, something a trust can directly control and does not demonstrate that the trust purposely availed itself to conduct business in North Carolina.[9]

In 2014, this Court further clarified the issue of general jurisdiction, which is relevant to general tax jurisdiction, in two cases. The Court in *Daimler AG v. Bauman*, 571 U.S. 117 (2014), justifiably expressed concerns relating to California's assertion of general jurisdiction over a foreign entity with very limited activity in the State. *See Daimler AG*, 571 U.S. at 139. The Court noted that if California had general jurisdiction over such an entity, then so would practically every other state. *Id.* "Such exorbitant exercises of all-purpose jurisdiction would scarcely permit out-of-state defendants to structure their primary conduct with some minimum assurances as to where that conduct will and will not render them liable to suit." *Id.* at 139 (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 472 (1985) (internal quotation marks omitted). The same holds true for the authority for a state and its local jurisdictions to have broad taxing authority over an entity, absent specific tax jurisdiction, that should be limited to an entity's home state location.

This Court also decided *Walden v. Fiore*, 571 U.S. 277 (2014), which limits a state's general tax jurisdiction. Citing *Burger King*, the Court noted that "the relationship must arise out of contacts that the defendant himself creates with the forum State."

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[9] *See J. McIntyre Mach., Ltd. v. Nicastro*, 564 U.S. 873, 886 (2011). "At no time did petitioner engage in any activities in New Jersey that reveal an intent to invoke or benefit from the protection of its laws." *Id.* at 887.

Walden, 571 U.S. at 284. In this case, the activities of a current beneficiary are being used inappropriately to assert that the trust, which is a separate legal entity, has sufficient contacts with North Carolina to be subject to the State's general jurisdiction. As noted in *Helicopteros*, "[the] unilateral activity of another party or a third person is not an appropriate consideration when determining whether a defendant has sufficient contacts with a forum State to justify an assertion of jurisdiction." *Helicopteros*, 466 U.S. 408, 417. While the beneficiary's residency is undisputed and the beneficiary clearly benefited from protections provided by the state of North Carolina, the trust, as a separate legal entity from the beneficiary, reaped no benefits or protections from the State.

This Court would greatly enhance the understanding of Due Process Clause limitations for state and local taxes by making it clear that general tax jurisdiction is restricted to the location where a taxpayer is domiciled. Although the assertion that a state may not exercise general taxing jurisdiction over a non-domiciled entity may seem novel, *amicus* is by no means contending that states are precluded from taxing non-domiciled entities based on the entity's specific activities within the state. In other words, a state can clearly assert jurisdiction to impose a tax based on the entity's specific activities within the state. This Court is now in a position to provide clear guidance as to types of activities that may be taxed and when an entity's activities within the state have risen to a level that would allow that state to impose such a tax under the Due Process Clause.

B. Specific Tax Jurisdiction Requires The Entity To Actually Be Conducting Business In The Forum Jurisdiction.

In *Wayfair,* this Court recently addressed what constitutes substantial nexus for Commerce Clause purposes,[10] removing the physical presence requirement for states to require out-of-state sellers to collect and remit sales and use taxes. *See Wayfair*, 138 S. Ct. 2080, 2099. Under the Due Process Clause, even if a state does not have general taxing jurisdiction over an entity, as discussed above, if the entity has purposely directed business activity towards the forum state, the entity could nonetheless have sufficient minimum contacts for due process purposes. An entity that purposely directs its business activity to purchasers in the forum state would likely be required to collect and remit that state's sales and use tax. A similar result could also hold true for states imposing a corporate income tax, whether it is solely imposed on the entity or on a combined group of related entities whose operations are unitary with the business activity conducted in the forum state.[11]

This Court addressed the issue of specific jurisdiction in *J. McIntyre Mach., Ltd.,* 564 U.S. 873. In

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[10] U.S. Const. Art. I, Sec. 8, cl. 3.

[11] As noted by this Court in *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425 (1980), "the linchpin of apportionability in the field of state income taxation is the unitary-business principle ... in order to establish that [income] is not to an apportioned tax in Vermont, the income [must be] earned in the course of activities unrelated to the sale of petroleum products in that State." *Id.* at 439. The activities need to be unitary: "Where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State, due process considerations might well preclude apportionability, because there would be no underlying unitary business." *Id.* at 442.

J. McIntyre, the Court was asked to determine whether a foreign entity was subject to the jurisdiction of a New Jersey state court where the entity was not present in a State at the time of the accident giving rise to the specific lawsuit. *See J. McIntyre*, 564 U.S. at 877. The foreign entity at the center of this case was a British manufacturer of scrap metal machines, which sold its machines into the U.S. market through a third-party distributor. *Id.* at 878. The foreign entity did not direct advertisements or otherwise solicit U.S. sales. *Id.* at 886. Through a third-party distributor, one of its machines ended up in a New Jersey facility, and that machine caused the injury that resulted in the lawsuit. *Id.* at 886-87.

Considering the facts in *J. McIntyre*, the Court focused on the foreign manufacturer's specific activities within New Jersey to determine whether it was subject to the specific jurisdiction of the State. *Id.* at 886-87. In other words, the Court focused on whether activities of the foreign manufacturer in New Jersey were sufficiently related to the injury giving rise to the lawsuit. *Id.* Finding that "the defendant does not have a single contact with New Jersey short of the machinery in question ending up in the State," the Court held that it had not "purposefully availed itself to the New Jersey market." *Id.* at 886.

J. McIntyre is important for two reasons. First, while a state may be precluded from asserting jurisdiction over an entity generally, there may be situations where an entity may be subject to a state's jurisdiction for a limited or specific purpose. As discussed above, only the state of domicile should have general taxing jurisdiction over an entity—meaning the entity can be subject to the full extent of the state's taxing authority. *Amicus* is not attempting to forestall

the states' ability to tax non-domiciliary entities because specific tax jurisdiction would allow the states to impose specific taxes upon such entities based on the specific activities of a particular entity within the state.

Second, *J. McIntyre* also highlights that it is the entity's activities, as opposed to the activities of a third-party, that must be considered when determining whether a state has jurisdiction. At no point in the Court's analysis in *J. McIntyre* did the Court look to the activities of the third-party distributor to determine whether J. McIntyre's activities gave rise to New Jersey being the appropriate forum to address that case. As discussed above with respect to general taxing jurisdiction, it is the taxpayer entity's activities, as opposed to some other third-party's activities, that must be considered. The same reasoning applies with respect to the determination of whether an entity is subject to the specific taxing jurisdiction of a non-domiciliary state. The failure to uphold the decision of the North Carolina court in this case involving a trust would eviscerate completely this requirement.[12]

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[12] Several other states have come to similar conclusions. In *Griffith v. ConAgra Brands, Inc.*, 229 W. Va 190 (2012), the Supreme Court of Appeals of West Virginia Supreme held an assessment against a licensor of products sold by others in the State did not "[satisfy] purposeful direction under the Due Process Clause." *Id.* at 200 (internal quotation marks omitted). The Supreme Court of Oklahoma also held "due process is offended by Oklahoma's attempt to tax an out of state corporation that has no contact with Oklahoma other than receiving payments from an Oklahoma taxpayer who has a bona fide obligation to do so under a contract not made in Oklahoma." *Scioto Ins. Co. v. Okla. Tax Comm'n*, 279 P.3d 782, 784 (2012). And, the Maryland Court of Appeals rejected the use of an "enterprise theory" to assert related entities would create sufficient contacts for due process

Such a ruling would also remove all semblance of due process requirements as they relate to state and local taxation. Although this case is specific to the income taxation of a trust, its implications will be far reaching. This Court should take this opportunity to provide guidance to entities as well as to the state and local jurisdictions regarding what the Due Process Clause requires in this area. Highlighting the differences as to how a state can tax an entity depending on whether it has general tax jurisdiction versus specific tax jurisdiction would benefit both taxpayers and state and local governments.

Amicus strongly encourages this Court to consider aligning its requirements regarding the jurisdiction to impose state and local taxes to the general and specific jurisdiction requirements recently laid out by this Court as discussed above. The ability of a state or local jurisdiction to impose tax on a non-domiciliary entity would in no way be foreclosed. Rather, such an entity's activities directed at a particular state or local jurisdiction would need to be considered more closely to determine if those activities were sufficient to satisfy the specific jurisdiction requirements prescribed by the Due Process Clause.

CONCLUSION

The Due Process Clause requires sufficient "minimum contacts" with a state or locality before an entity can be subject to the state or local government's taxing authority. This Court's recent Due Process Clause cases looking at whether an entity was subject to a state's jurisdiction should be used to guide taxpayers

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purposes. *Gore Enter. Holdings, Inc. v. Comptroller of the Treasury*, 437 Md. 492, 509 (2013).

and state and local governments on when a jurisdiction can assert its taxing authority over non-domiciliary entities.

Respectfully submitted,

FREDRICK NICELY
Counsel of Record
NIKKI DOBAY
KARL FRIEDEN
DAVID SAWYER
COUNCIL ON STATE TAXATION
122 C St. N.W., Suite 330
Washington, D.C. 20001
(202) 484-5222
fnicely@cost.org

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NORTH CAROLINA
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THE KIMBERLY RICE KAESTNER
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Respondent.

On Writ Of Certiorari To The Supreme Court Of North Carolina

BRIEF OF WILLIAM FIELDING, TRUSTEE, AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

WALTER A. PICKHARDT
Counsel of Record
LAURA S. CARLSON
CAITLIN E. ABRAM
NICHOLAS J. NELSON
FAEGRE BAKER DANIELS LLP
2200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402
(612) 766-7000
walter.pickhardt@faegrebd.com

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

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STATEMENT OF INTEREST OF AMICUS CURIAE[1]

Amicus is William Fielding, the trustee of four irrevocable inter vivos trusts (the "Fielding Trusts"). Minnesota taxed Mr. Fielding, as trustee, on the world-wide income of the Fielding Trusts under a law that defined a trust as a resident if the trust's *grantor* was domiciled in Minnesota at the time the trust became irrevocable. Minn. Stat. § 290.01, subd. 7b(a) (2014). The Minnesota Supreme Court held that Minnesota's rule—as applied to the Fielding Trusts, which had only "extremely tenuous" contacts with Minnesota—was unconstitutional under the Due Process Clause. *Fielding v. Comm'r of Revenue*, 916 N.W.2d 323 (Minn. 2018). The Minnesota Commissioner of Revenue filed a petition for certiorari in *Fielding* on November 15, 2018, and the case is pending before this Court.

North Carolina in the instant case classifies a trust a resident based on a *beneficiary's* domicile in the state. Pet. App. 2a. Although Minnesota's residency statute does not reference the domicile of a trust beneficiary, the Minnesota Supreme Court in *Fielding* reviewed the fact that one of the beneficiaries was a Minnesota resident. That beneficiary (the grantor's only son) was a contingent *current* beneficiary of the trust that was formed for his primary benefit. (His

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[1] Counsel for the parties were not in any way involved in authoring this brief. No person or entity, other than amicus and his counsel, made a monetary contribution to fund the preparation and submission of this brief. The parties to the case have filed blanket consents to the filing of amicus briefs.

interest was contingent because he had no vested right to distributions.) He was a contingent *remainder* beneficiary of the three similar trusts that were formed for the primary benefit of his sisters. (He might receive a distribution only if a sister predeceased him without surviving issue.) The Minnesota Supreme Court held that the son's domicile in Minnesota did not permit the state to treat any of the four trusts as residents.

Mr. Fielding submits this amicus brief in support of the Respondent because the decision here may affect the *Fielding* case.

SUMMARY OF ARGUMENT

A trust is not a legal entity capable of paying tax. Therefore, under North Carolina law, the liability to pay state income taxes falls upon the trustee, not the trust itself. N.C. Gen. Stat. § 105-160.2. That reality is central to a correct understanding of the issues in this case.

Petitioner agrees that a trust is "just an abstraction that describes a fiduciary relationship." Pet. Br. 16. However, ignoring that the legal duty to pay the tax is on the trustee, Petitioner claims that due process minimum contacts can be provided by *any* of "the trust's constituents—the grantor, the trustee, and the beneficiary." *Id.* When a similar argument was advanced in a case involving adjudicatory jurisdiction over a trust, this Court described the position taken by Petitioner

in this case as a "non-sequitur." *Hanson v. Denckla*, 357 U.S. 235, 254 (1958).

Hanson involved a trust dispute in a Florida court. The beneficiaries were Florida residents. The grantor was a Florida resident at her death. The trustee, who was an indispensable party to the trust litigation, was located in Delaware. Applying the Due Process Clause, this Court held that connections to Florida provided by the beneficiaries and the grantor were irrelevant. The relevant minimum contacts were those of the trustee, and because the trustee had not purposefully availed itself of the privilege of conducting activities within Florida, there was no jurisdiction in Florida.

This case involves minimum contacts for state tax purposes, which also is a due process requirement. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-273 (1978). Although it involves state tax rather than adjudicatory jurisdiction, the two situations require "comparable reasoning." *Quill Corp. v. North Dakota*, 504 U.S. 298, 308 (1992). Thus, the North Carolina Supreme Court correctly held below that the domicile of the trust beneficiaries did not create minimum contacts to make the trustee liable for taxes.

Moreover, the trust beneficiaries here did not have a vested interest in trust corpus or income. Even if the state contacts of a vested beneficiary might *sometimes* justify imposing a tax-paying duty on the trustee, the speculative interest of a contingent beneficiary should not be sufficient.

Due process also requires that the income taxed by North Carolina be rationally related to the values connected with the state. *Moorman*, 437 U.S. at 273. Taxing a person as a resident, on all worldwide income, requires substantial contacts with the state, such as domicile, but the taxpayer trustee here had no contacts with North Carolina.

Petitioner's argument that the decision below results in a "judicially created tax shelter" assumes that North Carolina has no choice but to tax trust income to the trustee. That is not correct. Even under current state law, North Carolina can tax trust income to a grantor if the federal grantor trust rules apply, and it can tax trust income to a beneficiary who has certain powers over trust corpus or income. See sections 671-678 of the Internal Revenue Code of 1986, as amended ("I.R.C."), which are incorporated into North Carolina law.

Moreover, North Carolina could follow the lead of some other states and amend its laws to provide for a "throwback rule" under which a resident trust beneficiary would be taxed on any accumulated trust income that has escaped taxation when the income is received by the beneficiary. That is how the federal government taxes accumulated income received by United States beneficiaries from foreign trusts. I.R.C. §§ 665-668.

ARGUMENT

I. Introduction.

The Due Process Clause allows a state to tax a nonresident on income having a source within the state. *Shaffer v. Carter*, 252 U.S. 37 (1920). By contrast, a state may tax its own residents on income they earn from anywhere in the world. *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937); *Lawrence v. State Tax Comm'n*, 286 U.S. 276 (1932).

The trust in this case (the "Trust") had no North Carolina source income. However, Petitioner claims that the Trust can be taxed on all of its income as if it were a North Carolina resident.

The Trust's only contact with North Carolina was that the current beneficiaries (the grantor's daughter and her children), were residents of North Carolina during the tax years at issue. They were contingent beneficiaries because the trustee had the discretion to make, or not to make, distributions to them. The grantor was a New York resident who created the trust in New York. The trustee during the years at issue lived in Connecticut. The trust assets were financial investments whose custodian was in Massachusetts.

North Carolina law imposes a tax on the income of a trust "for the benefit of a resident of this State." N.C. Gen. Stat. § 105-160.2 (2017). The trust (which is not a legal entity) is not itself liable for the tax. Neither the beneficiary nor the grantor are liable for the tax.

The statute imposes liability for the tax on the trustee. *Id.*

The Due Process Clause places two restrictions on a state's power to tax income. First, a state may not tax income unless it has some minimum connection with the taxpayer and its income-generating activity. This is sometimes called the "nexus" requirement. Second, even where a minimum connection exists, the State may tax only so much of the income as is rationally related to "values connected with the taxing State." *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-273 (1978); see also *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992); and *Mobil Oil Corp. v. Comm'r of Taxes of Vt.*, 445 U.S. 425, 436-437 (1980). If a tax fails to comply with either of these restrictions, it violates due process.

II. The Trust Does Not Have Minimum Contacts (Nexus) with North Carolina.

A. The Relevant Minimum Contacts Are Those Between the Trustee and North Carolina.

Due process does not allow a state to tax a person *at all* unless the person has a minimum connection (nexus) with the state. *Moorman*, 437 U.S. at 272-273. But who is the relevant person in the case of a trust? The trust itself cannot be the relevant person because a trust is not "a distinct legal entity, but a 'fiduciary relationship' between multiple people." *Americold Realty Tr. v. Conagra Foods, Inc.*, 136 S.Ct. 1012, 1016 (2016).

Amici trust law professors point out that the "abstract nature of a trust has notable consequences": (1) a lawsuit must be brought against the trustee, not the trust;[2] (2) a trustee can own legal title to property but a trust cannot; and (3) a trustee can enter into contracts but a trust cannot. Brief of Amicus Curiae Law Professors in Support of Petitioner, at 14-15. In short, a trust acts through its trustee.

Although legally not an entity, a trust is treated as a "person" for federal income tax purposes:

> [A] trust is an abstraction. . . . Even so, the law has seen fit to deal with this abstraction for income tax purposes as a separate existence, making its own return *under the hand of the fiduciary* and claiming and receiving its own appropriate deductions.

Anderson v. Wilson, 289 U.S. 20, 27 (1933) (emphasis added); accord *Greenough v. Tax Assessors*, 331 U.S. 486, 493-494 (1947). The duty to file a trust federal income tax return and to pay federal income taxes does not fall on the grantor or any beneficiary; those duties fall on the trustee. See I.R.C. § 6903(a).

North Carolina law similarly treats a trust as an entity for state income tax purposes—and because a trust is not *actually* an entity, North Carolina similarly imposes the obligation to file an income tax return

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[2] See also *Americold*: "[A trust] relationship was not a thing that could be haled into court; legal proceedings involving a trust were brought by or against the trustees in their own name." 136 S.Ct. at 2016.

upon the fiduciary of a trust (i.e., the trustee). N.C. Gen. Stat. § 105-160.5. North Carolina also makes the "fiduciary responsible for administering the . . . trust" liable to pay the state income tax. N.C. Gen. Stat. § 105-160.2.

Petitioner acknowledges that a trust is "just an abstraction that describes a fiduciary relationship," but then draws the mistaken conclusion that, for due process purposes, minimum contacts can be provided by *any* of "the trust's constituents—the grantor, the trustee, and the beneficiary." Pet. Br. at 16. This Court, when faced with a similar argument in an adjudicatory jurisdiction case, described it as a "non-sequitur." *Hanson v. Denckla*, 357 U.S. 235, 254 (1958).

In *Hanson*, an inter vivos trust was created by a grantor who was domiciled in Pennsylvania. The trust agreement was executed in Delaware. The grantor appointed a Delaware corporate trustee, Wilmington Trust. The grantor later became a Florida resident and remained a Florida resident until her death. While in Florida, she executed a will and also an inter vivos power of appointment under the trust in favor of the children of one of her daughters, who were Florida residents. Her other daughters, also Florida residents, were residuary legatees under her will. The residuary legatees challenged the validity of the trust power of appointment in a Florida court, and obtained a judgment that the trust was invalid, that the power of appointment was not effective, and that all the property passed under the residuary clause of the will. But a Delaware court, in competing litigation, upheld the

trust and power of appointment, and also held that the Florida ruling was not binding because Florida lacked personal jurisdiction over the trustee.

This Court considered the jurisdiction issue by applying the "flexible standard" of *International Shoe v. Washington*, 326 U.S. 310 (1945) which, it observed, jettisoned the "rigid rule" of *Pennoyer v. Neff*, 95 U.S. 714 (1878). *Hanson*, 357 U.S. at 251. The "minimal contacts" limitation on personal jurisdiction, the Court said, is "a consequence of territorial limitations on the power of the respective States." *Id.* The Court noted that "it is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." *Id.* at 253. Under Florida law, in order to enter a judgment affecting the validity of a trust, the trustee was "an indispensable party over whom the court must acquire jurisdiction." *Id.* at 254. The Court held that the trustee did not have minimum contacts with Florida:

> We fail to find such contacts in the circumstances of this case. The defendant trust company has no office in Florida, and transacts no business there. None of the trust assets has ever been held or administered in Florida, and the record discloses no solicitation of business in that State either in person or by mail. . . . The cause of action in this case is not one that arises out of an act done or transaction consummated in the forum State.

Id. at 251. The Court considered and rejected the claim that there was jurisdiction because the grantor (settlor) and the beneficiaries were domiciled in Florida:

> It is urged that because the settlor and most of the appointees and beneficiaries were domiciled in Florida the courts of that State should be able to exercise personal jurisdiction over the nonresident trustees. This is a non sequitur. . . . [Florida] does not acquire that jurisdiction by being the "center of gravity" of the controversy, or the most convenient location for litigation. The issue is personal jurisdiction, not choice of law. It is resolved in this case by considering the acts of the trustee. As we have indicated, they are insufficient to sustain the jurisdiction.

Id. at 254.

Here Petitioner argues, by analogy to adjudicatory jurisdiction cases, that a "fairness-based analysis has replaced the rigid, presence-focused analysis that prevailed in the years after *Pennoyer*." Pet. Br. 20. Petitioner argues that *Greenough*, decided two years after *International Shoe*, reflects the shift away from *Pennoyer*. Pet. Br. 27.[3] Of course, *Hanson* explicitly

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[3] *Greenough* held that the state in which a trustee is domiciled may impose a property tax on the trust's intangible property. 331 U.S. at 488, 498. Petitioner badly misreads the case as holding that a state can impose a tax on trust income if *any trust constituent* (the grantor, the trustee, or the beneficiary) resides in the state, even though only the trustee resided in the state in *Greenough*. Pet. Br. 16, 26-31. In fact, it was critical to the decision that "the intangibles [were] subject to [the trustee's] immediate control" and that the trustee enjoyed the benefits and protections of

followed *International Shoe* and rejected *Pennoyer*. But Petitioner claims that it is distinguishable because it involved "adjudicative jurisdiction over a *trustee*, not tax jurisdiction over a trust." Pet. Br. 24.

Petitioner's argument fails. This case does not involve tax jurisdiction *over a trust*, because a trust is not a taxable entity. North Carolina law imposes the obligation to file tax returns and to pay tax on the trustee, not the trust. N.C. Gen. Stat. § 105-160.2 and 105-160.5. The *Kaestner* trustee (Mr. David Bernstein) is indispensable to the liability to pay tax, just as the trustee in *Hanson* was indispensable to litigation concerning the trust.

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the taxing state. 331 U.S. at 493, 496. By contrast, in *Safe Deposit & Tr. Co. v. Virginia*, 280 U.S. 83 (1929), the Court held that the state where the beneficiaries and the grantor resided could not tax intangibles where the trustee was located in another state, and he controlled the trust assets. See also *Brooke v. City of Norfolk*, 277 U.S. 27, 27-28 (1928) (city where beneficiary resided could not tax trust corpus because "the property is not within the State, does not belong to the [beneficiary] and is not within her possession or control."). Contrary to Petitioner's claim, *Greenough* and *Safe Deposit* are consistent: Both held that the trust property could be taxed where it was held and controlled by the trustee. Cf. Pet. Br. 27-28. Petitioner also incorrectly states that *Safe Deposit* is not good law because it was premised on the view that due process prohibits double taxation. Pet. Br. 28, n. 12. Although the Court mentioned double taxation, its holding was based firmly on the rule that due process prevents a state from taxing things "wholly beyond her jurisdiction or control." 280 U.S. at 92. Moreover, Justice Stone's concurring opinion (joined by Justice Brandeis) made it clear that the "threat of double taxation" was not controlling. *Id.* at 95-96.

This Court has held that the state tax nexus requirement is closely related to the due process standard for adjudicatory jurisdiction. *Quill Corp. v. North Dakota*, 504 U.S. 298, 308 (1992). In *Quill*, the Court traced the development of the purposeful availment standard from *International Shoe* through later cases, and then said that "comparable reasoning" would apply in a sales tax case. *Id.* at 307-308. In a concurring opinion, Justice Scalia (joined by Justices Kennedy and Thomas) agreed that the Court's holding was "compelled by reasoning 'comparable' to that contained in our post-1967 cases dealing with state jurisdiction to adjudicate." *Id.* at 320. Although *Quill* involved sales tax collection, Justice Scalia noted that the Court's precedents rejected a distinction "between jurisdiction to tax and jurisdiction to compel collection of taxes as agent for the State." *Id.*

The purposeful availment test applies here, so the question is whether Mr. Bernstein, the trustee, purposefully availed himself "of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." *Hanson*, 357 U.S. at 253. Like the trustee in *Hanson*, Mr. Bernstein had no office in the state (North Carolina), transacted no business there, and solicited no business there. None of the trust assets has ever been held or administered in North Carolina. Citing *Hanson* and other adjudicatory jurisdiction cases, the North Carolina Supreme Court correctly held that there was no jurisdiction to tax the trustee on the trust income. Pet. App. 13a. The court did not count benefits that North

Carolina provided to the resident beneficiaries, since they are separate legal persons. That outcome follows naturally from *Hanson*—where the residency of trust beneficiaries did not create jurisdiction over the trustee.[4]

Amici tax law professors claim that the Trust—by which they presumably mean Mr. Bernstein—purposefully availed itself (himself) of North Carolina benefits because it (he) directed activities toward the beneficiaries. Brief of Tax Law Professors as Amici Curiae in Support of Petitioner, at 5 (hereinafter, "Tax Prof. Br."). However, the efforts of the trustee in *Hanson* were also aimed at the beneficiaries, who were domiciled in Florida, yet that did not give Florida jurisdiction. The tax law professors compare Mr. Bernstein's activities (directed to North Carolina beneficiaries) to those of the catalog retailer in *Quill*, which had a due process nexus because it directed marketing efforts to North Dakota customers. *Id.* That is a false analogy. Serving as a fiduciary to residents of the state is not comparable to trying to exploit a commercial market in that

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[4] *Hanson* is a foundational case that has been often cited by this Court in its due process decisions. *Hanson* establishes that jurisdiction must arise out of the person's own contacts and not those of a third party. That principal was reaffirmed recently in *Walden v. Fiore*, 571 U.S. 277 (2014). The Court there described *Hanson* as follows: "We have . . . rejected a plaintiff's argument that a Florida court could exercise personal jurisdiction over a trustee in Delaware based solely on the contacts of the trust's settlor, who was domiciled in Florida and had executed powers of appointment there." *Id.* at 284.

state. There is no evidence that Mr. Bernstein did the latter.[5]

B. Even If Minimum Contacts Could Be Established by a Resident Beneficiary, the Beneficiary Would Have to Be Vested, Not Contingent.

North Carolina's statute does not distinguish between vested and contingent beneficiaries. A vested beneficiary is one who, by the terms of the trust, is entitled to receive in a given year all or a portion of the trust's income or prinicipal. Contingent beneficiaries are those who *may* receive trust income or principal, depending on future events or the discretion of the trustee.

Mrs. Kaestner and her three children were contingent *current* beneficiaries during the tax years at issue because they were not entitled to receive any distributions. Distributions were discretionary with the trustee, Mr. Bernstein, who made no distributions.

There were also contingent *remainder* beneficiaries of the Trust, none of whom resided in North Carolina. Jt. App. 11, 39, 52. Those beneficiaries might receive

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[5] The tax law professors' argument proves too much. If the presence of a trust beneficiary in a state creates nexus to tax a trust's income, by analogy the presence of a corporate shareholder in a state would create nexus to tax the corporation's income, even if the corporation had no other contacts with the state. No state has understood its taxing powers to be so expansive.

trust assets if, for example, the contingent current beneficiaries passed away without surviving issue.

North Carolina seems to have ignored the contingent remainder beneficiaries and treated all of the Trust's income as taxable by the state because the contingent current beneficiaries resided in North Carolina. However, a state might tax a trust as a resident based on the in-state residence of a contingent remainder beneficiary. That is not hypothetical.

The *Fielding* case from Minnesota, to which amicus is a party, involves four siblings. Each sibling is the contingent current beneficiary of one trust, and a contingent remainder beneficiary for the three others siblings' trusts. Only one of the siblings was a Minnesota resident; the other three lived in New York and California. But, because those three trusts have a single Minnesota contingent remainder beneficiary, the Minnesota Commissioner of Revenue takes the position that Minnesota can tax them as Minnesota residents on 100 percent of their income.

If the states where the other siblings resided were also to adopt such a rule, each state would tax all four trusts as residents. Multiple taxation would result, which would be impermissible under the Commerce Clause. See *Comptroller of Treasury of Md. v. Wynne*, 135 S.Ct. 1787, 1802-1803 (2015).[6] Amici tax professors

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[6] Petitioner cites *Curry v. McCanless*, 307 U.S. 357 (1939), for the proposition that the Due Process Clause is not concerned with double taxation. Pet. Br. 28, n. 12. In *Curry*, this Court upheld *both* a Tennessee transfer tax upon the death of a state

assure the Court that multiple taxation is not a problem because states allow their residents credits for taxes paid to other states, and they cite to the North Carolina credit statute. Tax Prof. Br. at 27, citing N.C. Gen. Stat. § 105-160.4. However, the North Carolina credit is typical in that it applies only to taxes imposed on income derived from *sources* in another state. *Id.* The Trust had investment income, which is generally deemed not to have a source within another state. States generally "will deny a resident a credit for taxes paid to other states on investment income derived from intangibles." Hellerstein, Hellerstein & Swain, *State Taxation* (3rd ed. 2001, updated December 2018) ¶ 20.09[2][b].[7]

For this reason, and because the interest of a contingent remainder beneficiary may be highly speculative, if (notwithstanding *Hanson*) the Court holds that the presence of a beneficiary satisfies minimum

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resident who exercised a general power of appointment over intangible property held by a trustee in Alabama, *and* an Alabama inheritance tax on the transfer of that same trust-held property, where the decedent's will was probated in both states. Thus, *Curry* involved death transfer taxes. This Court has never addressed whether double taxation of *income* is permissible under due process. Regardless, even the *threat* of double taxation of income is a problem under the Commerce Clause. See *Wynne, supra*.

[7] There was actual double taxation of one of the trusts in the *Fielding* case by California and Minnesota. Minnesota's credit was unavailable for taxes paid to California on investment income.

contacts, it should not extend that holding to include contingent remainder beneficiaries.

Indeed, because the interest of a contingent current beneficiary in trust income is also speculative, the Court should hold that the current beneficiaries' residence in North Carolina does not satisfy the minimum contacts test. Those beneficiaries had no right to any trust income during the tax years in question, and they might never receive all (or even any) of the accumulated trust income.

III. North Carolina Seeks to Tax 100 Percent of the Trust's Income, Which Is Not Rationally Related to "Values Connected with the Taxing State."

Even when there is a minimum connection between the taxpayer and a state, the state may tax only so much of the taxpayer's income as is rationally related to "values connected with the taxing State." *Moorman*, 437 U.S. at 272-273; *Quill*, 504 U.S. at 306.

When a state seeks to tax 100 percent of a person's worldwide income by treating him as a resident, the required connection to the state must be substantial. Domicile (where a person makes his home) traditionally provides the basis for taxing an individual as a resident because "[e]njoyment of the privileges of residence within the state, and the attendant right to invoke the protection of its laws, are inseparable from the responsibility for sharing the costs of government." *Lawrence*, 286 U.S. at 278. Some states treat a

non-domiciled individual as a resident if the individual spends more than one-half the year physically present in, and has an abode in, the state. See, e.g., Minn. Stat. § 290.01, subd. 7(b) (2018); N.Y. Tax Law § 605(b)(1)(B) (2018). There too, the connection is substantial—state protections and services are provided for most of the year.

In this case, North Carolina would tax the trustee (Mr. Bernstein) on 100 percent of the trust's income, even though the only contact with the state is that of third parties, the trust beneficiaries. Petitioner asserts that the state provides legal benefits and protections to the beneficiaries. Pet. Br. 17. That might allow North Carolina to tax *the beneficiaries*. However, the tax here is imposed on Mr. Bernstein, who has no contacts with North Carolina.

Moreover, even if it were correct to consider state benefits provided to a beneficiary as establishing a rational relationship to trust income, in this case the beneficiaries residing in North Carolina had no vested interest in trust income or corpus. Distributions to them during the tax years at issue were solely within the discretion of Mr. Bernstein, who made no distributions.[8]

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[8] Amici tax law professors assert that state benefits provided to the beneficiaries, such as schooling, also benefited the Trust, which would otherwise have to make distributions to pay for schooling. Tax Prof. Br. 12-15. However, that is just a roundabout way of saying that, because of public schools, distributions could be made to the beneficiaries for other purposes—the beneficiaries might benefit, not the Trust or the trustee. Thus, amici are

IV. By Following Federal Models for the Taxation of Grantors and Beneficiaries, North Carolina Can Prevent Tax Sheltering.

Petitioner asserts that if the Court affirms the North Carolina Supreme Court, a so-called "judicially created tax shelter" will exist because states will be limited to taxing intangible trust investment income (not having a source within the state) based on the domicile of the trustee (or other place of trust administration), and the trustee can be located in a no-tax state. Pet. Br. 40.

That does not help Petitioner, for several reasons. First, there is no "avoiding tax shelters" exception to the Due Process Clause. Due process precludes taxing a trustee on trust income based on state contacts with third parties, such as the beneficiary or the grantor. State revenue consequences are simply irrelevant to that analysis. Second, states are not limited to taxing trust income to just the trustee. Most states (including North Carolina) already incorporate provisions of the Internal Revenue Code that tax trust income to a

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improperly using contingent beneficiary contacts to establish jurisdiction whereas the relevant contacts are those of the trustee. *Cf. Kulko v. Superior Court*, 436 U.S. 84, 94 (1978) (state services provided to daughter did not create jurisdiction over nonresident father, even though he had a support obligation). Amici also claim that North Carolina provides a forum for litigation, Tax Prof. Br. 13-14, but *Hanson* establishes that there would be no jurisdiction in North Carolina to litigate trust issues. Of course, a trustee might litigate other disputes (such as commercial disputes) in the various states where they arise. However, that does not mean that every state has the requisite rational relationship to tax *all* of the Trust's worldwide income.

resident grantor or beneficiary in appropriate situations. Third, states can tax a resident beneficiary on previously-untaxed accumulated trust income when the income is distributed to the beneficiary. Some states have already taken this approach.[9]

For the taxable years at issue, North Carolina defined state taxable income as federal taxable income, with certain modifications. N.C. Gen. Stat. § 105-134.5. North Carolina therefore adopted the federal grantor trust rules. I.R.C. §§ 671-677. These rules tax trust income to the grantor in cases where the grantor retains certain reversionary interests in corpus or income, retains the power to control beneficial enjoyment of corpus or income, retains certain administrative powers over the trust, retains the power to revoke the trust, or retains the right to receive income without the approval of an adverse party. Thus, a North Carolina resident cannot simply form a grantor trust with a trustee in a nontax state and expect to escape North Carolina tax.

Similarly, North Carolina incorporates I.R.C. § 678. Under that section, if a trust beneficiary has a power exercisable solely by herself to vest the corpus or the income in herself, the beneficiary is treated as

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[9] Under Subchapter J of the Internal Revenue Code, which states generally follow, beneficiaries are taxed on distributions of net income earned during the taxable year. Petitioner's concern is with the taxation of income *accumulated* by a trust, which is taxed to the trustee. If such income is not taxed to the trustee, it might be taxed to the beneficiary when a distribution is received, as discussed below.

the owner and is taxed currently on the trust's income whether or not the income is actually distributed. This is a substance-over-form provision, but it did not apply to the beneficiaries here during the years at issue because they had no right to demand distributions.

To be sure, North Carolina could not use I.R.C. § 678 to tax a *contingent* beneficiary on undistributed trust income, but that is appropriate. The exercise of dominion over income is a requirement for a person to be taxed on the income. *First Sec. Bank of Utah v. Comm'r*, 405 U.S. 397, 403 (1972) ("[I]n order to be taxed for income, a taxpayer must have complete dominion over it."); see also *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955); *Comm'r v. Indianapolis Power & Light Co.*, 493 U.S. 203, 209-210 (1990); and *Comm'r v. Banks*, 543 U.S. 426, 434-435 (2005).

But North Carolina easily could tax trust income that is actually distributed to contingent beneficiaries domiciled in the State. To do so, it could adopt rules similar to the federal throwback rules of I.R.C. §§ 665-668. For the federal government, these rules prevent revenue loss when a foreign trust is established for the benefit of a United States beneficiary. To the extent that the income of the foreign trust is not currently taxed, when the beneficiary receives a distribution he must pay a throwback tax, which is computed by "throwing" the income back to the tax years of the beneficiary that correspond to the years when the trust earned the income. A credit is allowed for any tax paid by the trustee on the income.

Some states have already adopted state throwback rules to tax resident beneficiaries on distributions from nonresident trusts. See, e.g., Cal. Rev. & Tax Code § 17745(b); 61 Pa. Code § 105.5(c); N.Y. Tax Law § 612(b)(40).[10] North Carolina could adopt similar legislation to prevent future revenue losses.

Petitioner points out that a beneficiary might move out of the state before receiving a distribution. Pet. Br. 40. But *bona fide* relocations simply are not tax avoidance. Petitioner's hypothetical is similar to a situation where a person owning appreciated stock moves to another state before selling it, or gives the stock to a child domiciled in another state. These situations are generally not regarded as involving tax avoidance because changing domicile, or gifting stock, have material non-tax consequences. To be sure, some beneficiaries may attempt tax avoidance through sham relocations, but states have ample authority to prevent such schemes. For example, California addresses the problem by statute:

> In the event that a person is a resident beneficiary during the period of accumulation, and leaves this state within 12 months prior to the date of distribution of accumulated income and returns to the state within 12 months after distribution, it shall be presumed that the beneficiary continued to be a resident of this state throughout the time of distribution.

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[10] In *McCulloch v. Franchise Tax Board*, 390 P.2d 412 (Cal. 1964), the court upheld California's throwback tax on a resident beneficiary who received distributions of untaxed trust income.

Cal. Rev. & Tax Code § 17745(e). North Carolina could adopt a similar rule. In appropriate cases, judicial anti-abuse doctrines might also apply.

CONCLUSION

The judgment of the North Carolina Supreme Court should be affirmed.

Respectfully submitted,

WALTER A. PICKHARDT
Counsel of Record
LAURA S. CARLSON
CAITLIN E. ABRAM
NICHOLAS J. NELSON
FAEGRE BAKER DANIELS LLP
2200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402
(612) 766-7000
walter.pickhardt@faegrebd.com

Counsel for Amicus Curiae

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In The Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST,

Respondent.

On Writ of Certiorari to the Supreme Court of North Carolina

BRIEF OF *AMICUS CURIAE* LAW PROFESSORS IN SUPPORT OF PETITIONER

STEPHEN D. FELDMAN
Counsel of Record
THOMAS H. SEGARS
SCOTTIE FORBES LEE
PREETHA SURESH RINI
ELLIS & WINTERS LLP
4131 Parklake Avenue, Suite 400
Raleigh, NC 27612
(919) 865-7005
stephen.feldman@elliswinters.com

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

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STATEMENT OF INTEREST OF *AMICUS CURIAE*[1]

Amici are law professors who have studied the history, purpose, and taxation of trusts. *Amici* teach courses on the laws governing trusts and estates, taxation, and property, and have published extensive scholarship on the law of trusts. *Amici* submit this brief to show that a beneficiary is and always has been the central constituent of a trust. As a result, a beneficiary's residency in a taxing state necessarily creates a significant relationship between the taxing state and the trust income that is the object of the tax. *Amici* urge the Court to weigh these points in reaching its decision in this case—a decision likely to have long-term consequences for the law on trusts.

John V. Orth is the William Rand Kenan Jr. Professor of Law at the University of North Carolina School of Law.

Kent D. Schenkel is a Professor of Law at New England Law Boston.

Carla Spivack is the Oxford Research Professor at the Oklahoma City University School of Law.

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[1] In accordance with Supreme Court Rule 37.6, *amici* state that no counsel for a party authored this brief in whole or in part, and that no person or entity, other than *amici* and their counsel, made a monetary contribution intended to fund the preparation and submission of this brief. All parties have filed letters granting blanket consent to the filing of *amicus* briefs.

Danaya C. Wright is the Clarence J. TeSelle Endowed Professor at the University of Florida Fredic G. Levin College of Law.

SUMMARY OF ARGUMENT

The question presented in this appeal is whether the Due Process Clause prohibits a state from taxing the income of a trust based on a trust beneficiary's in-state residency. The Supreme Court of North Carolina concluded that the Due Process Clause imposes this prohibition. That conclusion, however, clashes with the history, purpose, and established legal treatment of trusts.

A beneficiary's in-state residency is a uniquely relevant factor in establishing taxing jurisdiction. A trust's three basic constituents—settlor, trustee, and beneficiary—may make contact with different states. Among those constituents, however, only a trust's beneficiary is entitled to trust income. It follows that contacts with a state made by a trust's beneficiary bear the closest relationship to the object of income taxation: income from the trust corpus.

This brief begins with a discussion of the history that led to the modern-day trust, focusing on the beneficiary's essential role in the trust relationship. It then examines four key attributes of modern-day trusts that confirm a beneficiary's central and unique role in a trust. The brief applies the history and key attributes to the decision below, concluding that a

beneficiary's contacts with a state must be a cardinal consideration in establishing taxing jurisdiction.

ARGUMENT

I. The history of trusts shows that the trust was developed to preserve property for a beneficiary.

The Supreme Court of North Carolina concluded that the residency of a trust beneficiary is insufficient to determine whether a taxing state's contacts with the trust satisfy the Due Process Clause. This conclusion, however, overlooks the purpose of a trust. A trust is created to benefit a trust beneficiary.

A look at the history of the law on trusts shows that the arrangement has always existed for this purpose. *Amici* urge the Court to consider this history in assessing the role of a beneficiary's residency in the Court's due-process analysis.

A. The predecessor to the modern trust—called a "use"—facilitated property transfers in the face of feudal restrictions.

Trust law traces its roots to the Middle Ages, when feudal lords controlled English lands. John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 Yale L.J. 625, 632 (1995). In exchange for vows of allegiance and military service to protect the land, the lords granted partial rights of use and exploitation to

tenants. Francesco Parisi, *Entropy in Property*, 50 Am. J. Comp. L. 595, 599 (2002).

Tenants, however, could not pass these rights from one generation to the next. Langbein, *supra*, at 632–33. This is because the feudal lords restricted who could own the land. *Id.* at 632; Parisi, *supra*, at 599. These restrictions meant that tenants could not devise their land rights by will. Kent D. Schenkel, *Trust Law and the Title-Split: A Beneficial Perspective*, 78 UMKC L. Rev. 182, 185 (2009) [hereinafter Schenkel, *Trust Law and the Title-Split*]; *see also* Langbein, *supra*, at 632–33.

These limitations carried on even after the feudal system dissolved. Land ownership transferred only by descent and, until the enactment of the Statute of Wills in 1540, 32 Hen. 8 c. 1, could not be devised by will to others. *See* Langbein, *supra*, at 632–33; David T. Smith, *The Statute of Uses: A Look at Its Historical Evolution and Demise*, 18 Case W. Res. L. Rev. 40, 60 (1966); *cf.* W. D. Rollinson, *Principles of the Law of Succession to Intestate Property*, 11 Notre Dame L. Rev. 14, 15 (1935) (discussing the transmission of land by "descent" and by "devise"). Resentful of these laws, property owners looked for a way to facilitate the transfer of their land to their wives and children. Schenkel, *Trust Law and the Title-Split*, *supra*, at 189; *see also* Langbein, *supra*, at 632–33.

These dynamics gave rise to what was known as a "use." Langbein, *supra*, at 632–33. In a use, a landowner transferred the land's legal title to a person

known as a "feoffee," who held the title for the use of the landowner and his family.[2] Schenkel, *Trust Law and the Title-Split*, *supra*, at 186. The feoffee held the land's legal title, but the living landowner and his family retained the land's economic and personal benefits. *Id.* A use therefore defeated the feudal-era restrictions of property ownership: when the landowner died, his family retained the land's benefits, effectuating the functionality of a will. *Id.* In this way, uses were created to benefit the landowner's family.

B. The trust developed from the "use" and had the same core function of preserving property for a beneficiary.

The evolution and purpose of the use set the stage for the creation of the modern trust—the relationship at the heart of this case.

Because English common law did not recognize the use, disputes about uses were heard in English courts of equity. Howard L. Oleck, *Historical Nature of Equity Jurisprudence*, 20 Fordham L. Rev. 23, 37 (1951). Disputes arose based on the separation between legal title (which belonged to the feoffee) and the benefits of that title (which belonged to the landowner and his family). *See* Langbein, *supra*, at 634; Schenkel, *Trust Law and the Title-Split*, *supra*, at 186–87.

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[2] A "feoffee to uses" is "[a] person to whom land is conveyed for the use of a third party." *Feoffee to uses*, *Black's Law Dictionary* (10th ed. 2014).

In resolving these disputes, courts of equity bypassed common-law precedent and provided redress, such as specific performance, for injuries in circumstances where the common-law courts were not authorized to act. Schenkel, *Trust Law and the Title-Split*, *supra*, at 187; Oleck, *supra*, at 37–38; *see also* Langbein, *supra*, at 634. In particular, the courts of equity required the feoffee to follow the landowner's instructions to benefit his family after his death. Schenkel, *Trust Law and the Title-Split*, *supra*, at 187. English law reasoned that "after the trust creator died, the property belonged to the living beneficiaries of the dead creator's largesse once they came of age." Kent D. Schenkel, *Exposing the Hocus Pocus of Trusts*, 45 Akron L. Rev. 63, 71 n.31 (2012) (quoting Ronald Chester, *From Here to Eternity? Property and the Dead Hand* 47 (2007)).

On this theory—and through the exercise of their powers—courts of equity strengthened the beneficiary's interest by treating the "use" as an incorporeal thing that could be divided. Gregory S. Alexander, *The Dead Hand and the Law of Trusts in the Nineteenth Century*, 37 Stan. L. Rev. 1189, 1197 (1985). Thus, the beneficiary did not hold an estate in land but instead held an estate in "use." *Id.*

The law on trusts originated from this theory and these equitable powers. Although modern-day trusts include complex portfolios with various assets, the principles that control the trust relationship find their roots in the history described above. Those principles empower a trustee to transact with the trust property,

see Langbein, *supra*, at 637–42, but they do not change the essential character of a trust: an abstract device designed to hold, manage, preserve, and distribute wealth, all for the benefit of the beneficiary.

II. Key attributes of modern trusts confirm that a beneficiary is the central figure in the trust relationship.

Having evolved from English courts of equity, modern trusts possess several key features that bear on the due-process analysis in this case: (1) the law does not recognize a trust relationship in the absence of a beneficiary; (2) a beneficiary holds a property interest in the trust corpus; (3) a trustee's conduct must advance the beneficiary's interest; and (4) a trust is not a legal entity.

These features confirm that the trust beneficiary is a focal point of the trust relationship, enjoying unique rights and interests in the trust's corpus. Only the trust beneficiary is entitled to income derived from the trust corpus. For that reason, the contacts that a trust's beneficiary makes with a taxing state must be leading considerations in determining whether the state's taxation of trust income comports with the Due Process Clause.

A. A trust cannot exist without a beneficiary.

As discussed above, the use was created to aid a landowner's family; without the use, the family would

lose the benefit of the land after the landowner's passing. *See* Langbein, *supra*, at 633. Put another way, the landowner had no independent reason to convey legal title to a feoffee other than to ensure that his family would receive the land's benefits after his passing. *See id.* And the "use" served no benefit to the feoffee, who was fundamentally a caretaker of the legal title. Schenkel, *Trust Law and the Title-Split*, *supra*, at 186 (describing the feoffee's role as merely to "follow the landowner's instructions with respect to [the land's] use and disposition").

The same is true today. Trusts owe their entire existence to their beneficiaries, and the law does not even recognize a trust relationship unless the trust's terms provide a beneficiary. Unif. Trust Code § 402 (Unif. Law Comm'n 2000) (amended 2010) ("A trust is created only if . . . the trust has a definite beneficiary . . . ."); Restatement (Third) of Trusts § 44 (Am. Law Inst. 2003); 90 C.J.S. *Trusts* § 4 (2010) ("The existence of a beneficiary is an indispensable element of an express trust, and in the absence of a beneficiary, the effort to create such trust aborts.").

The absence of a trustee, in contrast, does not jeopardize the law's recognition of a trust. Restatement (Third) of Trusts § 31; Alan R. Bromberg & E. B. Fortson, *Selection of a Trustee; Tax and Other Considerations*, 19 Sw. L.J. 523, 524 (1965) ("It is hornbook law that a trust will not be permitted to fail for want of a trustee; the courts will supply one if the grantor does not."); *see also* Unif. Trust Code § 704 (providing procedure for filling a vacancy in trusteeship). Nor does the

absence of a settlor endanger the law's recognition of a trust relationship. *See* 76 Am. Jur. 2d *Trusts* § 3 (2016); Henry Hansmann & Ugo Mattei, *Trust Law in the United States. A Basic Study of Its Special Contribution*, 46 Am. J. Comp. L. Supp. 133, 134 (1998).

In sum, the existence of a trust is entirely "incidental to and derivative of the purpose of benefiting the trust beneficiary." Schenkel, *Trust Law and the Title-Split*, *supra*, at 183. A trust without a beneficiary is therefore a legal nullity.

B. Only the trust beneficiary holds a beneficial property interest in the trust corpus.

Because a trust is established to hold property for a beneficiary, it follows that a beneficiary has a cognizable property interest in the trust corpus.[3] *See Blair v. Comm'r*, 300 U.S. 5, 14 (1937) (recognizing that the beneficiary of an inter vivos trust has a vested interest in the trust—an "estate in and to property" of the trust); *see also Pennsylvania v. Stewart*, 12 A.2d 444, 446–47 (Pa. 1940) (noting that "the beneficiary also has rights in rem, an actual property interest in the subject-matter of the trust"), *aff'd*, 312 U.S. 649 (1941); 3 Helene S. Shapo et al., *The Law of Trusts and Trustees*

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[3] *Amici* acknowledge that some trust-law scholars believe that a beneficiary's interest is promissory, not proprietary. *See, e.g.*, Langbein, *supra*, at 644 (discussing this debate among trust-law academics). That view, however, is defeated by the equitable origins of the trust described above. *See id.* at 644–47.

§ 183, at 512 (3d ed. 2012) (noting that the beneficiary's interest in modern-day trusts has "become increasingly a right in rem and is now substantially equivalent to equitable ownership of the trust res").

The beneficiary's property interest is equitable in nature. *Stone v. White*, 301 U.S. 532, 537 (1937); *see* 76 Am. Jur. 2d *Trusts* § 1; 17 Alan Newman et al., *The Law of Trusts and Trustees* § 962, at 19 (3d ed. 2010). It is also more than a mere right; it is a form of title. *See Blair*, 300 U.S. at 13–14 (describing a beneficiary's interest as a "right, title, and estate in and to property"); 90 C.J.S. *Trusts* § 265; Schenkel, *Trust Law and the Title-Split*, *supra*, at 181 n.2.

Beneficiaries can exercise equitable title in important ways. For example, beneficiaries may enforce the trust, sue to enjoin a trust breach, and obtain damages from a breach. *Blair*, 300 U.S. at 13. A beneficiary's trust interest—in the absence of a spendthrift clause or other express restraint—is also freely alienable; beneficiaries can freely "transfer a part of [their] interest as well as the whole."[4] *Id.* In addition, absent a spendthrift clause, beneficiaries can use their trust interest as security for credit, either (1) by expressly pledging their interest in the trust corpus to creditors

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[4] A spendthrift clause contains language that protects the beneficiary's income and principal interests from the claims of the beneficiary's creditors. Restatement (Third) of Trusts § 58 cmt. d(2). Aimed at protecting beneficiaries who spend in excess of income, a spendthrift clause bars the beneficiary from pledging undistributed trust assets as security for a loan or other debts during the term of the trust.

or (2) by leveraging the interest as a security for credit by relying on their overall wealth, inclusive of their interest in the trust property, to induce creditors to extend unsecured credit. Hansmann & Mattei, *supra*, at 138.

A trustee does not have these rights. This is so even though the trustee holds the legal title of the trust corpus. The trustee's legal title does not permit the trustee to benefit from the trust corpus. A trustee therefore cannot use trust assets to satisfy obligations to the trustee's creditors. 76 Am. Jur. 2d *Trusts* § 256 (explaining that "a trustee's interest in trust property is not subject to liability for his or her private, as distinguished from his or her official, debts and obligations"); 90 C.J.S. *Trusts* § 260 ("A fundamental tenet of trust law is the protection of the trust estate from a trustee's personal creditors."). A settlor also does not have these rights. Unless expressly allowed by statute in the jurisdiction, a settlor's creditors—like a trustee's creditors—cannot reach trust property (as long as the settlor is not also a beneficiary). Hansmann & Mattei, *supra*, at 139.

Only the beneficiary holds equitable title to the trust corpus—title that affords the beneficiary benefits unavailable to the settlor and the trustee. This fact further reinforces the unique relationship between a trust and its beneficiary.

C. A trustee's obligation is to advance the beneficiary's interests.

A beneficiary's central role in a trust relationship is also highlighted by the nature of the trustee's obligations.

As discussed above, English courts of equity fashioned remedies that recognized a beneficiary's cognizable interest in trust property. Schenkel, *Trust Law and the Title-Split*, *supra*, at 186–87. The feoffee's duty was to hold and manage legal title to that property consistent with the settlor's instructions. *See id.* To protect the beneficiary's interest, courts of equity stepped in if a feoffee breached that duty. *Id.* at 187.

A trustee's power to manage a modern trust's assets is no different: it is bound by a fiduciary duty to the trust beneficiaries. Langbein, *supra*, at 640–42. In other words, the laws that once restricted a feoffee's conduct evolved into the modern "law of fiduciary administration." *Id.* at 640. A trustee's core duty is to display "complete loyalty to the interests of the beneficiary" and to exclude "all selfish interest and all consideration of the interests of third persons." 11 George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* § 543, at 217 (2d rev. ed. 1993); *see also* Unif. Trust Code § 802 ("A trustee shall administer the trust solely in the interests of the beneficiaries."). This Court itself has described a trustee as "a fiduciary owing undivided loyalty to the interest of the beneficiaries in administering the trust," *NLRB v. Amax Coal Co.*, 453 U.S. 322, 327–28 (1981), and has

emphasized that the rule of undivided loyalty "must be enforced with 'uncompromising rigidity,'" *id.* at 330 (quoting *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928)).[5]

The duty of loyalty is not the only duty that a trustee owes to a beneficiary. A trustee also owes each beneficiary a duty to exercise "reasonable care, skill, and caution" in administering the trust "as a prudent person would, in light of the purposes, terms and other circumstances of the trust." Restatement (Third) of Trusts § 77(1)–(2). The beneficiary can sue to enforce the trustee's obligation to perform those duties. *See* Hansmann & Mattei, *supra*, at 134.

A trustee can even be removed from the trust relationship under certain circumstances, including by a beneficiary. *See* Restatement (Third) of Trusts § 37 cmt. b (noting that the terms of the trust may authorize a beneficiary to remove the trustee). A court has discretion to remove a trustee for proper cause. *Id.* cmt. d ("A court may remove a trustee whose continuation

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[5] These duties are the same even where the terms of a trust provide the trustee with "absolute" or "sole" discretion over the trust. Because trusts are solely for the benefit of beneficiaries, terms describing a trustee's discretion are not interpreted literally under the law of trusts. Unif. Trust Code § 814(a) (noting that the breadth of discretion granted to the trustee in the terms of the trust do not alter a trustee's duty to act for the interests of the beneficiaries); Restatement (Third) of Trusts § 50 cmt. c (explaining that "words such as 'absolute' or 'unlimited' or 'sole and uncontrolled' are not interpreted literally"); *see also* Unif. Trust Code § 105(b)(3) (noting that the terms of a trust cannot evade "the requirement that a trust and its terms be for the benefit of its beneficiaries").

in that role would be detrimental to the interests of the beneficiaries."). A beneficiary, on the other hand, cannot be removed because to do so would defeat the purpose of the trust. *See supra* pp. 7–8.

The takeaway from these points is this: a trustee holds legal title to trust property, but does so subject to the possibility of being removed and exclusively "to facilitate the *beneficiaries'* enjoyment." Langbein, *supra*, at 655 (emphasis added).

D. A trust is not a separate legal entity, but a relationship created for a beneficiary.

The principles laid out above—that a trust fails for want of a beneficiary, that the beneficiary has a cognizable interest in the trust corpus, and that the trustee's obligations run to the beneficiary—provide the framework for a final and significant tenet of trust law: a trust is not an entity at all, but a relationship to safeguard property for a beneficiary. *Americold Realty Tr. v. ConAgra Foods, Inc.*, 136 S. Ct. 1012, 1016 (2016) ("Traditionally, a trust was not considered a distinct legal entity . . . ."); *Anderson v. Wilson*, 289 U.S. 20, 27 (1933) ("[T]he trust is an abstraction . . . the law has seen fit to deal with this abstraction for income tax purposes as a separate existence . . . ."); 76 Am. Jur. 2d *Trusts* § 2 ("A trust is not a legal entity."); *see also* Unif. Trust Code § 202 (providing for jurisdiction only over the trustee and beneficiary).

The abstract nature of a trust has notable consequences. For example, a trust cannot be sued.

Americold Realty Tr., 136 S. Ct. at 1016; 76 Am. Jur. 2d *Trusts* § 2. Instead, a lawsuit involving a trust is filed against the trustee in a representative capacity. *See Americold Realty Tr.*, 136 S. Ct. at 1016; Restatement (Third) of Trusts § 105.

Similarly, a trust cannot own property. *See* 76 Am. Jur. 2d *Trusts* § 2. Although a trust holds property, it does not own the property. *See* Restatement (Third) of Trusts § 40. The trustee holds legal title to the property in a fiduciary capacity. *See* Robert T. Danforth, *Rethinking the Law of Creditors' Rights in Trusts*, 53 Hastings L.J. 287, 290 (2002) ("[A]lthough the trustee is strictly speaking the 'owner' of the trust assets, the trustee owns those assets not for the trustee's own benefit, but for the benefit of the beneficiaries, for whom the trustee is a fiduciary."); Samuel Williston, *The Right to Follow Trust Property When Confused with Other Property*, 2 Harv. L. Rev. 28, 28 (1888) (noting that term "trustee" indicates "any one holding money or property in a fiduciary capacity"). The beneficiary, on the other hand, holds equitable title in the property. *Supra* pp. 10–11.

A trust also cannot enter into contracts. 76 Am. Jur. 2d *Trusts* § 2. Unlike a corporation, a trust cannot bind itself because it is not a legal entity. *See id.* Instead, the trustee, acting in a representative capacity, can enter into contracts in the course of administering the trust. *See* Restatement (Third) of Trusts § 105 cmt. c.

In sum, the law does not treat a trust as a legal entity, and a trust does not have any powers that legal entities traditionally have. A trust is something different: an arrangement among constituents that is marked by a fiduciary relationship between the trustee and the trust beneficiaries. *Americold Realty Tr.*, 136 S. Ct. at 1016; 76 Am. Jur. 2d *Trusts* § 2.

III. The contacts that a trust's beneficiary makes with a state cannot be disregarded in determining jurisdiction to tax income on a trust corpus.

In view of the historical purpose and legal treatment of trusts, a beneficiary enjoys unique rights to income on a trust's corpus. Because of those unique rights, a beneficiary's contacts with a state are important, if not dispositive, for purposes of determining jurisdiction to tax income on a trust's corpus. The Supreme Court of North Carolina erred in concluding otherwise.

This section first examines the parts of the holding below that overlook the significance of a beneficiary's contacts in the taxing-jurisdiction analysis. It then discusses the potential contacts with one or more states that the constituents of a trust may have. Finally, it explains why a beneficiary's contacts—more so than the other constituents of the trust—are of the nature and quality that matter for taxing jurisdiction.

A. The holding below misapplies this Court's instruction in *Quill* and overlooks important characteristics of trusts.

The holding below depends on this Court's instruction that due process requires "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992) (quoting *Miller Bros. v. Maryland*, 347 U.S. 340, 344–45 (1954)).

The Supreme Court of North Carolina misapplied this instruction. It held that the beneficiaries' contacts with North Carolina, which stem from residency in North Carolina, were insufficient under the analysis. *Kimberley Rice Kaestner 1992 Family Tr. v. N.C. Dep't of Revenue*, 814 S.E.2d 43, 51 (N.C. 2018). In its reasoning, however, the court below never examined the nature or quality of those contacts—an examination that *Quill* demands. *Quill*, 504 U.S. at 312 ("[A]t the most general level, the due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him.").

Instead, the decision below opined that trusts and their beneficiaries "have legally separate, taxable existences." *Kaestner*, 814 S.E.2d at 51. The court then reasoned that the trust's "link[s]" or "minimum connection[s]" to the state for taxing jurisdiction were also separate from those of the beneficiaries. *Id.* at 49 (quoting *Quill*, 504 at 306). The majority relied on this

Court's holding in *Walden v. Fiore*, 571 U.S. 277 (2014), which concluded that "unilateral activity of another party or a third person is not an appropriate consideration when determining whether a defendant has sufficient contacts with a forum State." *Kaestner*, 814 S.E.2d at 49 (quoting *Walden*, 571 U.S. at 284).

This reasoning reveals a misunderstanding of the nature of trusts, sidestepping at least three important features of the trust relationship.

First, a beneficiary is no "third person" or stranger to a trust. *Id.* (quoting *Walden*, 571 U.S. at 284). A beneficiary is a uniquely important constituent of the trust relationship—*a legal requisite* to the trust's existence. *See* Restatement (Third) of Trusts § 44 ("A trust is not created . . . unless the terms of the trust provide a beneficiary . . . .").

Second, given the fiduciary obligations owed to a beneficiary, a trust's relationship with its beneficiary is hardly a product of the beneficiary's "unilateral activity." *Walden*, 571 U.S. at 286, 291.

Third, although a particular trust may have a separate "taxable existence" for some purposes, many do not, and trusts are not distinct legal entities. *See supra* pp. 7–9, 14. The court's focus on the trust's "separate existence" is precisely the sort of overly formalistic analysis that this Court has rejected. *Quill*, 504 U.S. at 307 ("[W]e have abandoned more formalistic tests that focused on a defendant's 'presence' within a State in favor of a more flexible inquiry into whether a defendant's contacts with the forum made it reasonable . . . .");

see also South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2093 (2018) (reaffirming "[t]he reasons given in *Quill* for rejecting the physical presence rule for due process purposes"). It also reflects a misunderstanding of the title-split function of trusts, which ultimately are mere relationships among people. *See* Schenkel, *Trust Law and the Title-Split*, *supra*, at 181 n.2; *supra* pp. 7–9, 14–16.

Had the court below examined the nature and quality of the beneficiaries' contacts with North Carolina for jurisdictional purposes, it could not have disregarded those contacts.

B. The constituents of a trust may make "contact" with states.

A trust is not a legal entity. *See supra* pp. 8–11, 14. A trust therefore makes contact with a state through constituents of the trust relationship.

Each of these constituents—settlor, trustee, and beneficiary—may have contact with one or more states. *See* Jeffrey Schoenblum, *Strange Bedfellows: The Federal Constitution, Out-of-State Nongrantor Accumulation Trusts, and the Complete Avoidance of State Income Taxation*, 67 Vand. L. Rev. 1945, 1954 (2014).

In addition, the constituents of the trust relationship have contact with the state under whose law the trust was organized. *See* Unif. Trust Code § 107 cmt. (noting that the Uniform Trust Code "allows a settlor to select the law that will govern the meaning and

effect of the terms of the trust," even if the jurisdiction selected has no other connection to the trust).

In these ways, the constituents of a trust may have contacts with more than one state. Schoenblum, *supra*, at 1957. For instance, those constituents may have contacts with the state where the settlor resides, a second state where the trust is administered, and a third state where the beneficiary resides. *See id.* at 1954.

One constituent's contacts, however, touch a state in a particularly significant respect for purposes of establishing taxing jurisdiction.

C. The contacts made by the trust's beneficiary are the most significant for the purpose of establishing taxing jurisdiction.

Quill clarifies that the "link" or "connection" with a state that matters for establishing taxing jurisdiction is a link or connection with "the person, property or transaction [the state] seeks to tax." 504 U.S. at 306; *see also Wayfair*, 138 S. Ct. at 2093 (stating the due-process requirement that there be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax" (quoting *Miller Bros.*, 347 U.S. at 344–45)).

In taxing a trust, a state seeks to tax no "person," but rather "property"—specifically, income on a corpus. Of the potential contacts that the constituents of a trust may make with a state, contacts made by the

beneficiary are the most closely tied to income from the corpus—the object of the tax. This close tie to the object of the tax distinguishes the nature and quality of the beneficiary's contacts.

Unlike the other constituents of the trust relationship, only a beneficiary holds a beneficial property interest in the trust corpus. *See Blair*, 300 U.S. at 14. Indeed, "[t]rusts exist because of what they can do for the trust beneficiaries." Schenkel, *Trust Law and the Title-Split*, *supra*, at 183.

In fact, this Court's decision in *Stone v. White* specifically recognized a beneficiary's interests in trust income. *See Stone*, 301 U.S. at 534. *Stone* resolved a dispute among trustees, a beneficiary, and a taxing authority over the appropriate tax on trust income. *See id.* In resolving that dispute, this Court observed that, although the trustee and beneficiary were "distinct tax-paying entities, . . . it was the *beneficiary's* money which paid the tax and it is *her* money" that the trustees sought to have returned. *Id.* at 535 (emphasis added). Stated differently, when a tax is imposed on trust income, "only the equitable owner of the fund [that is, the beneficiary] is ultimately burdened." *Id.* at 538.

Contacts made by a trust's non-beneficiary settlor or trustee, by contrast, have a more attenuated relationship to the object of taxation.

A non-beneficiary settlor leaves the picture once trust assets have been transferred and retains no right or interest in the corpus. *See* Adam Hofri-Winogradow,

The Demand for Fiduciary Services: Evidence from the Market in Private Donative Trusts, 68 Hastings L.J. 931, 941 (2017) (explaining that once the trust property is held by the trustee, the settlor "steps out of the picture" and "no longer has any powers over either the trustee or the trust property"); *see also* Hansmann & Mattei, *supra*, at 144; *supra* pp. 8–9.

A trustee holds legal title, but serves as a fiduciary to administer the trust to advance the beneficiary's interest. *See* 76 Am. Jur. 2d *Trusts* §§ 334, 352; Bogert & Bogert, *supra*, § 543, at 217–18; *supra* pp. 9–13. As a fiduciary, a trustee cannot claim any equitable property interest in the corpus. *See Navarro Sav. Ass'n v. Lee*, 446 U.S. 458, 463 (1980) (noting that beneficiaries—as opposed to the trustee—have an equitable interest in the trust); Schenkel, *Trust Law and the Title-Split*, *supra*, at 181 n.2 (stating that the beneficiary holds the equitable title to the property while the trustee holds only legal title). Nor can the trustee receive any of the income generated by the trust. *See* Schenkel, *Trust Law and the Title-Split*, *supra*, at 181 n.2.

A trustee's connection to a state, moreover, is merely fortuitous. A particular trustee is impermanent, subject to being removed and replaced by a court or a beneficiary. *See supra* pp. 8, 13–14. Thus, the trustee's contacts to a particular state are impermanent as well, subject to being changed along with the particular trustee. *See supra* pp. 13–14. A beneficiary's connection to the trust, on the other hand, is permanent because the beneficiary cannot be removed from the trust relationship. *See supra* pp. 7–9, 13.

Although the contacts made by a settlor or trustee may be significant for some purposes, they are not the most significant for the purpose that matters here: the object of a state's tax. A trustee's contacts may be significant, for example, in determining who may sue on behalf of the trust. *See* Fed. R. Civ. P. 17(a)(1)(E) (identifying trustee as real party in interest); *Navarro*, 446 U.S. at 462 (holding that "trustees are real parties in interest for procedural purposes"). This rule makes sense in light of the trustee's duty to act as a fiduciary and to transact with assets. *See supra* pp. 12–13. Those contacts, however, bear a comparatively distant relationship to the object of taxation.

Nor does the law of the state where the trust was originally formed have any meaningful relationship to the object of taxation. No individual in the state where a trust is formed enjoys the benefits of the income generated by the trust—unless the beneficiary also lives in that state.

A beneficiary has the closest tie to income on a trust corpus, the object of a state's tax. For that reason, a beneficiary's contacts with a state—most often, that beneficiary's state of residence—are the most meaningful contacts under *Quill*'s due-process analysis. These contacts may be dispositive on the question of taxing jurisdiction. In any case, they cannot be disregarded.

CONCLUSION

For the foregoing reasons, the decision of the Supreme Court of North Carolina should be reversed.

Respectfully submitted,

STEPHEN D. FELDMAN
Counsel of Record
THOMAS H. SEGARS
SCOTTIE FORBES LEE
PREETHA SURESH RINI
ELLIS & WINTERS LLP
4131 Parklake Avenue, Suite 400
Raleigh, NC 27612
(919) 865-7005
stephen.feldman@elliswinters.com

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No. 18-457

In the Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,
Petitioner,

v.

THE KIMBERLY RICE KAESTNER 1992 FAMILY TRUST,
Respondent.

On Writ of Certiorari to the North Carolina Supreme Court

BRIEF FOR MINNESOTA AND NINETEEN OTHER STATES AND THE DISTRICT OF COLUMBIA AS AMICI CURIAE SUPPORTING THE PETITIONER

KEITH ELLISON
Attorney General
State of Minnesota

JOHN M. O'MAHONEY
Counsel of Record
Assistant Attorney General
445 Minnesota Street, Suite 900
St. Paul, Minnesota 55101-2128
(651) 757-1216
john.omahoney@ag.state.mn.us

Counsel for Amici Curiae

Additional counsel listed on signature pages

Becker Gallagher · Cincinnati, OH · Washington, D.C. · 800.890.5001

QUESTION PRESENTED

Does the Due Process Clause prohibit states from imposing income taxes on trusts that are administered outside their borders if the trust's beneficiaries are domiciled in the taxing state?

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INTEREST OF *AMICI CURIAE*

Pursuant to Supreme Court Rule 37, Minnesota, nineteen other states, and the District of Columbia respectfully submit this brief of *amici curiae* in support of the Petitioner, the State of North Carolina Department of Revenue.

Amici curiae are states with grave concerns about the due process and state sovereignty implications of the North Carolina Supreme Court's ruling in this case. The *amici* states, with the exception of Washington, rely on income taxes to operate and provide essential services to their residents. This case addresses the taxation of trusts, which states tax on a variety of bases, all of which require contact with the taxing state. Some, like North Carolina, tax based on the domicile of the beneficiary; others, like Minnesota, tax based on the location of the grantor; and still others focus on different contacts a trust has with the state. *Amici* are united in opposing the constrained contacts analysis set out in the North Carolina Supreme Court's decision. That decision, if affirmed, would call into question the constitutionality of the statutes of a large majority of states, and would potentially cost the states billions of dollars in tax revenue. It would also result in a "judicially created tax shelter," allowing trusts to avoid paying income taxes to *any* state.

The Due Process Clause does not require that result. The North Carolina Supreme Court's decision applied a due process analysis that cherishes form over substance and ignores the significant contacts created by an in-state beneficiary. Its analysis is inconsistent with both this Court's modern due process

jurisprudence and its longstanding precedents regarding trust taxation, neither of which relies mechanistically on the trustee's actions. The *amici* states have an abiding interest in this Court maintaining flexible due process standards and rejecting the North Carolina court's deviation from them.

SUMMARY OF ARGUMENT

The North Carolina Supreme Court's decision in this case conflicts with this Court's precedents and should be reversed. This Court has consistently looked to the substance, and not the form, of transactions for the purposes of its due process analysis, and does not adhere to formalistic rules in determining when constitutional minimum contacts have been satisfied. *See South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2093-94 (2018) (quoting *Quill Corp. v. North Dakota*, 504 U.S. 298, 308 (1992)). The decision in the case below imposes a formalistic standard that would disregard significant in-state contacts in the trust context. This is inconsistent with this Court's modern due process jurisprudence as it relates to taxation, which focuses on contacts with the forum rather than literal presence of persons or property, and should not be adopted.

The decision below also infringes on state sovereignty, and usurps legislative authority regarding taxation. Subject to the constitutional requirement of due process, state legislatures should be free to formulate state-specific policies regarding the taxation of trusts, rather than being bound to a formal requirement that a trustee or trust property must be

located in-state. All but seven states impose taxes on the income of trusts, and *three quarters* of those states predicate these taxes, in whole or in part on factors other than the location of the trustee. If affirmed, the decision below will call into question the statutory structures of all of these jurisdictions. Finally, the formalistic analysis proposed by the court below would cause the states to face a significant loss in tax revenues, if affirmed.

ARGUMENT

I. THE NORTH CAROLINA SUPREME COURT'S DECISION REPRESENTS A REVERSION TO A FORMALISTIC DUE PROCESS STANDARD THAT DISREGARDS ESSENTIAL TRUST CONTACTS.

A. The North Carolina Supreme Court's Decision Conflicts With This Court's Modern Due Process Jurisprudence.

By holding that only the trustee's contacts with a state are relevant to making the minimum-contacts determination, North Carolina has reverted to a formalistic rule that elevates substance over form. *See* Pet, App. 12a-13a. The decision dictates that the form of a trust is primary, and that because of this, the due process contacts of other parties to the trust like the beneficiary are irrelevant. *Id.*

This Court has long recognized, however, that for due process purposes, "[w]hen the question is whether a tax imposed by a State deprives a party of rights secured by the Federal Constitution, ... [w]e must regard the substance, rather than the form, and the controlling test is to be found in the operation and

effect of the law as applied and enforced by the State." *Lunding v. N.Y. Tax Appeals Tribunal*, 522 U.S. 287, 297 (1998) (*citing St. Louis Sw. R. Co. v. Ark.*, 235 U.S. 350, 362 (1914)). In order to give precedence to substance over form, and in recognition of "modern commercial life," the Court has ruled consistently that the Due Process Clause does not require the use of formalistic tests. *Quill*, 504 U.S. at 308 (*citing Int'l Shoe Co. v. Wash.*, 326 U.S. 310 (1945)).

Instead of a formalistic standard, due process for tax purposes long has been evaluated according to the more flexible standards set forth in *International Shoe* — specifically, whether a taxpayer has purposefully availed itself of the benefits of the taxing state. *Quill*, 504 U.S. at 307-08 (but also finding that a physical presence test was appropriate under the Commerce Clause for sales tax purposes). Once purposeful availment has occurred, the Due Process Clause merely requires that there be a rational relationship between the income attributed to a state and values connected with the state. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-273 (1978).

A fair and flexible standard consistent with this Court's modern due process jurisprudence would recognize the reality that the trust itself retains significant actual connections to its grantor and, even more importantly, to its beneficiaries, who are the equitable owners of the trust's assets. *See* Restatement (Third) of Trusts § 2 (2003) (explaining that trust beneficiaries hold equitable title to trust property). A proper due process standard would therefore consider, at the least, (1) the location of trustees; (2) the location

of beneficiaries; (3) the location and nature of trust assets; (4) the principal place of trust administration; (5) the location of the trust's creation; and (6) the grantor's domicile. *See e.g., Westfall v. Dir. of Revenue*, 812 S.W.2d 513, 514 (Mo. 1991).

The formalistic standard used by the North Carolina Supreme Court looks only at the first and fourth listed contacts, utterly ignoring the other three.[1] That approach yields perverse results, as can be seen in the Minnesota Supreme Court's similar holding in *Fielding v. Comm'r of Revenue*, 916 N.W.2d 323, 330 (Minn. 2018), petition for cert. pending, No. 18-664 (filed Nov. 15, 2018). Focusing solely on the trustee's lack of contacts with Minnesota, the court held that the State of Minnesota could not tax several trusts' income. That was so, held the court, even though the trusts had a variety of significant connections to the state: (1) they were created by a Minnesota resident; (2) their assets consisted of stock in a closely held corporation headquartered and operating in Minnesota; (3) the trust agreements were drafted in Minnesota and are governed by Minnesota law; (4) the grantor resided in Minnesota when the trusts became irrevocable; and (5) one of the beneficiaries resided in Minnesota. *Id.* at 330-333. The Minnesota Supreme Court deemed all of those contacts "irrelevant" for due process purposes because the trust was administered by a Texas resident during the tax year at issue. *Id.*

The approach taken by the Minnesota and North Carolina Supreme Courts contravenes this Court's

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[1] The court left open the possibility that real property owned by a trust could create relevant in-state contacts. Pet. App. at 35a.

modern precedents with respect to state taxation. As this Court explained in *Wayfair*, 138 S. Ct. 2080 (2018), in reversing its prior Commerce Clause jurisprudence regarding sales taxes, the Constitution does not command "arbitrary, formalistic distinction[s]." *Id.* at 2086. "It is essential to public confidence in the tax system that the Court avoid creating inequitable exceptions." *Id.* The North Carolina Supreme Court's rule would substantially undermine public confidence in state income tax systems because it would provide a substantial and unwarranted tax benefit to trust beneficiaries, which would not be extended to others.

As multiple other state courts of last resort have determined, a state can maintain constitutionally sufficient contacts with a trust through contacts with its grantor and beneficiaries, and not simply with an in-state trustee. *See e.g., McCulloch v. Franchise Tax Bd.*, 390 P.2d 412, 418 (Cal. 1964) (sustaining as constitutional a resident income tax founded upon residence of beneficiary);*Westfall v. Dir. of Revenue*, 812 S.W.2d 513 (Mo. 1991); *Dist. of Columbia v. Chase Manhattan Bank*, 689 A.2d 539 (D.C. 1997); *Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999); *T. Ryan Legg Irrevocable Trust v. Testa*, 75 N.E3d 184 (Ohio 2016). The rule employed in the North Carolina Supreme Court's decision is inconsistent with this Court's decisions in *Lunding, Quill,* and *Wayfair,* and should be reversed.

B. The North Carolina Supreme Court's Decision Conflicts With This Court's Trust Taxation Jurisprudence.

The North Carolina Supreme Court's decision also conflicts with the longstanding, still valid, holding in *Curry v. McCanless*, 307 U.S. 357 (1939). In *Curry*, this Court held that a trust could be subject to inheritance taxes in more than one state, when the trustee was located in one state and the trust's grantor and beneficiaries were located in another state. *Id.* at 368. In evaluating the trust's contacts for due process purposes, this Court determined that the contacts of both the trustee, and the trust's grantor and beneficiaries, were relevant in determining where the trust could be subject to taxation under the Due Process Clause. *Id.*

Central to this Court's ruling in *Curry* was the trust's management (as here) of intangible property, rather than tangible property. This Court explained that because intangible property does not occupy a fixed place in the physical world, unlike tangible property, it can create constitutionally sufficient contacts in multiple jurisdictions simultaneously. *Curry*, 307 U.S. at 368-369 (cautioning against "first ascribing to them a fictitious situs and then invoking the prohibition of the Fourteenth Amendment against their taxation elsewhere," in an effort to "prevent the taxation of diverse legal interests in intangibles in more than a single place"). Those principles cannot be reconciled with a rule that the only constitutionally relevant contact a trust has with a state is the situs of the trust and its trustee.

To be sure, *Curry* did not present precisely the same issue as this case. Most notably, *Curry* involved inheritance and transfer taxes on a trust's corpus, not income taxes. However, the central holdings of *Curry* bear directly on the present case: (1) the Due Process Clause does not confine the situs of intangible property to a single jurisdiction for tax purposes; and (2) contacts of both trustees and other parties to a trust are relevant for the purposes of the Due Process Clause. As *Curry* explained, in words that resonate here:

> We can find nothing in the history of the Fourteenth Amendment and no support in reason, principle, or authority for saying that it prohibits either state, in the circumstances of this case, from laying the tax. On the contrary this Court, in sustaining the tax at the place of domicile in a case like the present, has declared that both the decedent's domicile and that of the trustee are free to tax.

307 U.S. at 372–73 (1939) (internal citations omitted). *See also* Hellersten, Hellerstein, & Swain, State Taxation, at ¶ 20.09[2][a] (3d ed. 2018) (explaining that the holding in *Curry* substantially undermines the argument that states are constrained by the Due Process Clause from levying resident income taxes on trusts with on out-of-state trustees when the trust has other in-state contacts). This Court should reaffirm *Curry* and reject the ruling of the North Carolina Supreme Court.

II. THE DECISION BELOW WOULD IMPOSE A STRAIGHTJACKET ON STATES AND CAST IN DOUBT THE MAJORITY OF STATES' TAXING REGIMES.

This Court has long recognized that state legislatures "have considerable discretion in formulating tax policy." *Lunding v. N.Y. Tax Appeals Tribunal*, 522 U.S. 287, 297 (1998) (*citing Madden v. Kentucky*, 309 U.S. 83, 88 (1940)). The decision below significantly encroaches on that discretion because it concludes that only a trustee's contacts are constitutionally relevant for due process purposes. The majority of state statutes providing for trust taxation call for the consideration of factors other than the trustee's contacts, such as the contacts of grantors and beneficiaries. *See infra* fn. 4 and 5. Legislators in states utilizing these statutes presumably relied on this Court's ruling in *Curry* when concluding that they had the constitutional authority to tax trusts administered in other states based on the relevant contacts of grantors and beneficiaries. If affirmed, the rule proposed by the North Carolina Supreme Court would effectively establish a uniform national standard for trust taxation, and deprive states of the sovereign right to formulate tax policy pertaining to trusts.

Although states clearly have the authority to tax trusts on the basis of the location of a trustee, only twelve of the forty-four states imposing an income tax on trusts use the location of the trustee as the primary consideration in determining residency ("trustee-

domicile rules").[2, 3] Rather, the majority of states (twenty-seven) provide for some form of trust income taxation based on either the location of the beneficiary ("beneficiary-domicile rules") or the location of the grantor ("grantor-domicile rules"), without reference to the location of the trustee.[4] In a small number of states

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[2] For the purposes of this discussion the term "states" includes the District of Columbia. States that do not impose income taxes (on trusts or otherwise) include: Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming.

[3] We define trustee-domicile rules as those that impose taxes on the basis of the trustee's state of domicile or the location of the trust's administration. Some trustee-domicile rules also consider secondary factors. *See e.g.*, Mass. Code Regs. § 62.10.1 (2018), providing that an *inter vivos* trust is a resident of Massachusetts if: (1) at least one of the trustees is a Massachusetts resident; and (2) at least one of the grantors is or was a Massachusetts resident. The regulation considers more contacts than just the trustee's, but the trustee's presence is a necessary condition, making it a trustee-domicile rule. *See also* A.R.S. § 43-1301 (2018); Ark. Code Ann. § 26–51–201(a) (2018); Colo. Rev. Stat. § 39–22–103(10) (2018); Haw. Rev. Stat. § 235-1 (2018); Ind. Admin. Code tit. 45, r. 3.1-1-12 (2018); Kan. Stat. Ann. § 79-32,109(d) (2018); Ky. Rev. Stat. Ann. § 141.030 (2018); Miss. Code Ann. § 27-7-5(1) (2018); N.M. Stat. Ann. § 7-2-2(S) (2018); Or. Rev. Stat. § 316.282(1)(d) (2018); S.C. Code Ann. § 12–6–30(5) (2018).

[4] There are many nuances to the beneficiary-domicile and grantor-domicile rules amongst the states. For example, in Minnesota, trusts settled before 1995 are subject to a trustee-domicile rule, but trusts settled after 1995 are subject to a grantor-domicile rule. *See* Minn. Stat. § 290.01, subd. 7b (2018). Some other states have different rules for testamentary versus *inter vivos* trusts. *See, e.g.*, 830 Mass. Code Regs. § 62.10.1 (2018), providing that testamentary trusts of Massachusetts domiciliaries are subject to a grantor-domicile rule, while, as observed *supra* in fn. 2, resident *inter vivos* trusts are subject to a trustee-domicile rule. *See also* Conn. Gen. Stat. § 12-701 (2018); Del. Code Ann. tit. 30 § 1601

(six), multiple factors are considered, which sometimes include the location of the trustee, but not as a necessary condition for the imposition of the resident income tax.[5] For example, Alabama law provides that a testamentary trust is an Alabama resident trust if it: (1) is established by a decedent domiciled in Alabama; and (2) either the trustee or one of the trust beneficiaries was domiciled in Alabama for seven months of the tax year. Ala. Code § 40-18-1(33). Under the Alabama rule, the presence of a trustee is a relevant and potentially sufficient condition for the imposition of the tax, but it is not a necessary condition. The presence of the grantor at death and a beneficiary in a following year is also sufficient. *Id.* California, another multi-factor state, taxes trusts as residents if they either: (1) have a resident trustee; or

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(2018); D.C. Code § 47-1809.01 (2018); Del. Code Ann. tit. 30, § 1601(8) (2018); Ga. Code Ann. § 48–7–20(d) (2018); 35 Ill. Comp. Stat. 5/201 (2018); Iowa Admin. Code § 701-89.3 (2018); La. Stat. Ann. § 47:300.10 (2018); Me. Rev. Stat. Ann. tit. 36, § 5102(4) (2018); Md. Code Ann., Tax-Gen. § 10-101 (2018); Mich. Comp. Laws § 206.18 (2018); Minn. Stat. § 290.01 (2018); Mo. Rev. Stat. § 143.331 (2018); Mont. Admin. R. 42.30.101 (2018); Neb. Rev. Stat. Ann. § 77-2714.01 (2018); N.H. Rev. Stat. Ann. § 77:10 (2018); N.J. Stat. Ann. § 54A:1-2 (2018); N.Y. Tax Law § 605 (2018); N.C.G.S.A. § 105-160.2 (2018); Okla. Stat. tit. 68, § 2353 (2018); 72 Pa. Cons. Stat. § 7301 (2018); R.I. Gen. Laws § 44-30-5 (2018); Tenn. Code Ann. § 67-2-110(a) (2018); Utah Code Ann. § 59-10-201 (West 2018); Vt. Stat. Ann. tit. 32, § 5811 (2018); Va. Code Ann. § 58.1-302 (2018); W. Va. Code R. 110- 21-7 (West 2018) ; Wis. Stat. § 71.14(3) (2018).

[5] *See* Ala. Code § 40-18-1(33) (2018); Idaho Code § 63-3015 (2018); Cal. Rev. & Tax. Code §§ 17041, 17731, 17742, 17743; 17745 (2018); Mont. Admin R. 42.30.101 (2018); N.D. Admin R. 81-03-02.1-04 (2018); Ohio Rev. Code § 5747.01(I)(3).

(2) have a resident non-contingent beneficiary.[6] Again the presence of a trustee is a sufficient, but not a necessary condition.

Beneficiary-domicile states, grantor-domicile states, and states with multi-factor statutes (a total of thirty-three of the forty-four states imposing income taxes) will all be affected by the Court's decision in this case.[7] This is so because each of their statutes or rules expressly provides for the taxation of certain trusts administered in other states as residents, without reference to the contacts of the trustee. If the decision of the North Carolina Supreme Court is affirmed, the trust income taxation regimes of all of these jurisdictions will be called into question. This result would represent a significant encroachment on state sovereignty and is not required under the Fourteenth Amendment. *See Wayfair*, 138 S. Ct. at 2095-96 (noting that the Court should avoid "intrud[ing] on states' reasonable choices in enacting their tax systems" and observing that formalistic rules are inconsistent with the goals of "federalism and free markets").

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[6] Cal. Rev. & Tax. Code §§ 17041; 17731; 17742; 17743 (2018). California taxes trusts on the basis of beneficiary residence alone only when the beneficiary's interest in the trust is non-contingent. Nevertheless, when a previously contingent beneficiary receives a distribution from the trust, California will impose tax upon that distribution, even if it represents income accumulated during the period that the beneficiary's interest was contingent. Cal. Rev. & Tax. Code § 17745 (2018).

[7] Notably, even Washington, a state with no income tax, foresees negative consequences resulting from a constrained reading of the Due Process Clause and has joined the other *amici* asking this Court to reverse.

III. If the Decision of the North Carolina Supreme Court is Affirmed, it Will Create a Constitutionalized Tax Loophole For Trust Beneficiaries.

This Court recently admonished against the creation of "judicially created tax shelter[s]." *Wayfair*, 138 S. Ct. at 2085. Yet that is precisely what the North Carolina Supreme Court's due process ruling does. By their nature, trusts are extraordinarily mobile and versatile. *See* Stewart Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?*, 85 Cornell L. Rev. 1035, 1065 (2000). As the need for federal estate tax planning has diminished over time due to the increasing exemption amount, estate planners have increasingly targeted state income taxes for minimization through various forum shopping strategies. *See* Jay Soled and Mitchell Gans, *Asset Preservation and the Evolving Role of Trusts in the Twenty-First Century*, 72 Wash. & Lee L. Rev. 257, 277-280 (2015). The North Carolina court's rule makes it surpassingly easy for them to accomplish that goal and avoid *all* state taxes on trust income: simply park interest and dividend bearing assets such as securities into a trust that is administered in one of the seven states that does not impose an income tax. No other step is required, and the trust beneficiary achieves complete avoidance of state income taxation on their investment income.

And under the North Carolina Supreme Court's rule, individuals could avoid taxes on large capital gains, even when the accretion of wealth underlying the transaction took place while the taxpayer was

enjoying the protections of the laws and services of their state of domicile. The *Fielding* case discussed above is a perfect example. A trustee in Texas sold stock in a closely held family business that was headquartered in Minnesota for over 100 years, and was owned and operated by a Minnesota grantor — yet Minnesota was barred from taxing the capital gain because the Minnesota Supreme Court found that the business's ties to the State were "irrelevant" to the taxation of the trustee under the Due Process Clause. *Fielding* 916 N.W.2d at 326-333. Results like these threaten to dramatically undermine public confidence in our nation's tax system, as large tax benefits are conferred to trust beneficiaries but not others. Further, the resulting lack of confidence threatens to exacerbate the problem of non-compliance with all state and federal tax laws. *See* Dave Rifkin, *A Primer on the "Tax Gap" and Methodologies for Reducing It*, 27 Quinnipiac L. Rev. 375 (2009) (explaining that perceived unfairness in the income tax system drives increased noncompliance).

This concern is real. Experts have observed that "[o]ne of the most significant reasons for moving the situs of a presently existing (nongrantor) trust is to move an income-accumulation trust from a high income tax state to a low income tax state.". John Warnick and Sergio Pareja, *Selecting a Trust Situs in the 21st Century*, 16 Probate & Property 53, 57 (2002). This strategy is not limited to existing trusts, of course, as newly formed trusts adhere to the "basic" but "critical" strategy of "avoiding the selection of a trustee domiciled in a state that predicates taxation based upon a trustee's residency." Jay Soled and Mitchell

Gans, 72 Wash. & Lee L. Rev., at 277, n. 129 (2015). If the decision of the North Carolina Supreme Court is affirmed, tax avoidance through the use of out-of-state trustees will become even more prevalent.

State revenue shortfalls will not be minor. The North Carolina Department of Revenue has received more than 450 refund claims (so far) based on the outcome of this case, and the Minnesota Department of Revenue has received over 300 refund claims based on the outcome of *Fielding*. If the decision of the court below is affirmed, such claims will be filed in states across the country, which will create revenue losses that will be borne for years to come. The most recent data available on a nationwide scale shows that trusts filed 2.7 million returns in 2014, and paid federal taxes of more than $120 billion. Pet. at 12. There is a corollary state income tax for the vast majority of those 2.7 million trusts under current state statutes, and if they are allowed to completely avoid the payment of state income taxes based on a formalistic reading of the Due Process Clause, the majority of states will face real declines in state revenues.

Meanwhile, states continue to provide benefits and protections to their residents (and their interests in trust funds), even where the trustees reside and administer the trusts in other states for tax avoidance purposes. "The private enrichment that these newly minted trusts offer often comes at tremendous financial costs to the public." Soled and Gans, 72 Wash. & Lee L. Rev., at 295-96. This Court has long held that states' constitutional authority for imposing income taxes on their residents under the Due Process Clause

is inherent, and based on the states' offering the protections of its laws to in-state residents. *People of State of N. Y. ex rel. Cohn v. Graves*, 300 U.S. 308, 313, 57 S. Ct. 466, 467, 81 L. Ed. 666 (1937). Affirming a rule that would allow tax avoidance by in-state trust beneficiaries is fundamentally inconsistent with this principal; the Constitution does not mandate it and the Court ought to reject it.

CONCLUSION

For the foregoing reasons, the judgment of the North Carolina Supreme Court should be reversed.

Respectfully Submitted,

KEITH ELLISON
Attorney General
State of Minnesota

JOHN M. O'MAHONEY
Counsel of Record
Assistant Attorney General
Office of the Minnesota Attorney General
445 Minnesota Street, Suite 900
St. Paul, Minnesota 55101-2128
(651) 757-1216
john.omahoney@ag.state.mn.us

Counsel for Amici Curiae

Dated: March 1, 2019

COUNSEL FOR ADDITIONAL *AMICI*

STEVE MARSHALL
Attorney General
of Alabama

XAVIER BECERRA
Attorney General
of California

WILLIAM TONG
Attorney General
of Connecticut

PHIL WEISER
Attorney General
of Colorado

KARL A. RACINE
Attorney General
of The District of
Columbia

CHRISTOPHER M. CARR
Attorney General
of Georgia

LAWRENCE G. WASDEN
Attorney General
of Idaho

KWAME RAOUL
Attorney General
of Illinois

TOM MILLER
Attorney General
of Iowa

DANA NESSEL
Attorney General
of Michigan

TIM FOX
Attorney General
of Montana

DOUG PETERSON
Attorney General
of Nebraska

GRUBIR S. GREWAL
Attorney General
of New Jersey

WAYNE STENEHJEM
Attorney General
of North Dakota

DAVE YOST
Attorney General
of Ohio

MIKE HUNTER
Attorney General
of Oklahoma

ELLEN F. ROSENBLUM
Attorney General
of Oregon

PETER F. NERONHA
Attorney General
of Rhode Island

JOSH SHAPIRO
Attorney General
of Pennsylvania

ROBERT W. FERGUSON
Attorney General
of Washington

No. 18-457

IN THE

Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST,

Respondent.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF NORTH CAROLINA

BRIEF OF *AMICUS CURIAE* THE NEW YORK STATE BAR ASSOCIATION IN SUPPORT OF RESPONDENT

MICHAEL MILLER
President
ROBERT M. HARPER*
ANGELO M. GRASSO
JEFFERY H. SHEETZ
LOIS BLADYKAS
NEW YORK STATE BAR ASSOCIATION
One Elk Street
Albany, New York 12207
(518) 463-3200
rharper@farrellfritz.com

Counsel for Amicus Curiae

* *Counsel of Record*

287465

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

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INTEREST OF *AMICUS CURIAE*

The New York State Bar Association ("NYSBA") is the largest voluntary state bar association in the United States, with more than 72,000 members.[1] NYSBA's members live and practice in every town, city and county in the State of New York, and its membership also includes non-resident lawyers around the nation and throughout the world.

NYSBA has 26 sections dedicated to discrete areas of the law, including the Trusts and Estates Law Section, which consists of more than 3,000 members. With the assistance of its sections, as well as more than 60 committees, NYSBA drafts and supports legislation, sponsors conferences, seminars and institutes, and makes policy recommendations to bodies including the United States Congress, the New York State Legislature, and the New York State Office of Court Administration.

NYSBA previously has submitted *amicus curiae* briefs to the Supreme Court of the United States. NYSBA respectfully submits this brief in support of respondent, the Kimberley Rice Kaestner 1992 Family Trust ("Respondent"), and to assist the Court concerning the practical and policy implications of this case for the

1. NYSBA respectfully submits this brief, pursuant to the blanket-consent letters that the parties filed with the Court. Pursuant to Rule 37.6 of the Court's Rules, *amicus* affirms that no counsel for a party authored this brief, in whole or in part; that no such counsel or party has made a monetary contribution intended to fund the preparation or submission of this brief; and that no person other than *amicus* and its counsel made such a monetary contribution.

trusts and estates bar, as well as the grantors, trustees, and beneficiaries of trusts.

SUMMARY OF ARGUMENT

NYSBA respectfully submits this *amicus curiae* brief in support of Respondent. The court below correctly found that an out-of-state trust that did no business in North Carolina, had no assets in North Carolina, and distributed no income to anyone in North Carolina had no connection or substantial nexus with that state, which unconstitutionally taxed Respondent on its undistributed income. This accords with generally accepted trusts and estates law, which draws a distinction between a trust's trustee and its beneficiaries, and does not treat a trust as a vehicle to serve at the beneficiaries' behest.

With that in mind, NYSBA respectfully submits that North Carolina's argument that a beneficiary is "the central figure" in a trust is a mischaracterization of well-settled trusts and estates law. Pet. Br. at 2. Contrary to North Carolina's contention, the central figure in a trust is the trustee, who is the taxpayer, the fiduciary, and the owner of legal title in the trust's property. This distinction is all the more apparent here, where the trustee has absolute discretion to make (or not make) distributions, and the beneficiaries' rights are contingent upon that absolute discretion.

Given the nature and purpose of trusts, North Carolina's tax impermissibly violates the Due Process Clause of the Fourteenth Amendment to the United States Constitution, as well as the Commerce Clause contained in the Constitution, by taxing trustees who

have no relationship with North Carolina. The tax violates the Due Process Clause because it does not require that a trustee have the requisite "minimum connection" with the state, nor does it require the existence of a rational relationship between North Carolina and the income it seeks to tax. As to the Commerce Clause, the tax fails the four-part test set forth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), as there is no nexus between Respondent and North Carolina, and the tax is neither internally consistent nor externally consistent. Hence, the decision below should be affirmed.

ARGUMENT

I. A Trust Is Separate and Distinct from Its Beneficiaries, and Should Be Treated as Such for Purposes of State Income Taxation of Undistributed Trust Income.

To justify the state income tax that it assessed against Respondent, North Carolina effectively argues that no legal distinction exists between a trust and its discretionary beneficiaries. North Carolina's contention flatly contradicts the governing trusts and estates law, which this Court should apply in rejecting North Carolina's position.

A trust "is a fiduciary relationship with respect to property, subjecting [the person] by whom the title to property is held, to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it." Restatement (Second) of Trusts § 2. The trust relationship has three essential requirements: (1) "an expression

of intent that property be held, at least in part, for the benefit of one other than the settlor;" (2) "at least one beneficiary for whom the property is to be administered by the trustee;" and (3) "an interest in property which is in existence or is ascertainable and is to be held for the benefit of the beneficiary." George T. Bogert, *Trusts* § 1 (6th ed. 1987) ("Bogert on Trusts"); *Brown v. Spohr*, 73 N.E. 14 (N.Y. 1904).

A trust may be created for any lawful purpose, N.Y. E.P.T.L. § 7-1.4, but the most common reason for establishing a trust is to separate the control of trust assets from its beneficiaries. Restatement (Second) of Trusts § 59, cmt. b. As a result, legal title to trust property vests in the trustee, not in a beneficiary. *Stephens v. Tipton*, 268 P. 1014, 1015 (Or. 1928). The bifurcation of legal and beneficial title to trust assets is fundamental to the very existence of a trust; for if legal and beneficial title are not separated (such that legal and beneficial title to trust property rest in the same individual or entity), no trust arises. *Id.*

Beneficiaries are not "owners" of trust assets in the common sense of the word. On the contrary, because a trustee is a fiduciary, and fiduciaries and beneficiaries are separate entities, *Abell v. Tait*, 30 F.2d 54, 55 (4th Cir. 1929) (citing, *e.g.*, *Merchants' Loan & Tr. Co. v. Smietanka*, 255 U.S. 509 (1921)), *cert. denied*, 279 U.S. 849 (1929), a trust beneficiary's interest in trust assets is "non-possessory." Bogert on Trusts, § 38.

A trustee has legal ownership of trust assets, at least until trust distributions are made. The trustee's legal ownership of trust assets typically carries with it the

power to sell trust assets, to invest trust property, and to collect the income earned on trust property. Bogert on Trusts, § 88. A beneficiary has no such powers. In fact, a beneficiary's rights with respect to trust property are derivative, not direct, and are subject to the possessory rights that a trustee has as to trust assets. *Western R.R. Co. v. Nolan*, 48 N.Y. 513, 518-19 (N.Y. 1872). For example, in order to assert a cause of action on behalf of a trust, the trustee, not a beneficiary, must commence an action, even though that action ultimately may inure to the beneficiary's benefit. *Noel v. Liberty Bank of Ark.*, No. 3:10-CV-00107, 2012 WL 13027498, at *8 (E.D. Ark. Nov. 27, 2012).

Given the foregoing, and the nature of the trustee-beneficiary relationship, it logically follows that a beneficiary's right to distribution of trust assets is subject to limitations. It is governed by the terms of the trust instrument, pursuant to which the trust is created. Bogert on Trusts, § 38. As memorialized in the trust instrument, the settlor's intentions are entitled to great latitude in fixing beneficiaries' interests in a trust, and not all trust beneficiaries are created equal. The trust instrument may direct that a beneficiary's equitable interest in trust assets is subject to a definite period of trust administration, or that the trust's administration shall continue indefinitely. *Id.*; Wis. Stat. § 700.16. Likewise, the trust instrument may provide that a trust beneficiary's interest is contingent or vested; is in trust income or principal; is subject to a condition precedent or subsequent; or is possessory or non-possessory. Bogert on Trusts, § 38.

A settlor may direct that a trustee make certain distributions to specific beneficiaries (whose rights

are "mandatory"), or may "authorize the trustee to do or refrain from doing a certain act, or use his [or her] judgment as to when or how a power should be used." Bogert on Trusts, § 89. Put another way, a settlor may vest the trustee with partial or absolute discretion to make trust distributions. *Id.* In general, a trustee's exercise of discretion in making trust distributions (or refraining from doing so) will only be disturbed, by courts or otherwise, upon a showing that the trustee did not act in good faith. *Id.*; *In re Harmon*, 900 N.Y.S.2d 761, 764 (N.Y. App. Div. 2010). The trustee's exercise of discretion in distributing trust assets is entitled to tremendous deference, regardless of the wishes of trust beneficiaries (and, oftentimes, much to beneficiaries' chagrin). *Id.*

Further demonstrating the dichotomy that exists between trusts and their beneficiaries is the fact that courts typically will not require trustees to exercise their discretion to make trust distributions in a manner that would allow for beneficiaries' creditors and assignees to gain access to trust assets. *Lineback by Hutchens v. Stout*, 339 S.E.2d 103, 106 (N.C. Ct. App. 1986). Indeed, courts have explained that, under a "discretionary trust, the trustee may withhold the trust income and principal altogether from the beneficiary and the beneficiary, as well as the creditors and assignees of the beneficiary, cannot compel the trustee to pay over any part of the trust funds." *Id.*

In order to justify the unconstitutional state income tax that it seeks to levy against Respondent, North Carolina argues that a beneficiary is "the central figure in a trust." Pet. Br. at 2. North Carolina's contention overlooks well-settled trust law, which establishes that

three figures are essential to a trust: the settlor, the trustee, and the beneficiaries. The trust's beneficiaries are not, as North Carolina argues, more important to the trustee-beneficiary relationship than the trustee.

In fact, for the purpose of determining the legal ownership of assets that are held in trust, the beneficiaries are less important to the trust relationship than the trustee is. During the relevant tax years, the beneficiaries' ability to receive income distributions was subject to the trustee's absolute discretion. Joint Appendix ["App."] 45-47. As he was permitted to do under the terms of Respondent trust, the trustee did not exercise his discretion to distribute income to the beneficiaries during the 2005, 2006, 2007, or 2008 tax years. *Id.* at 12.

Legal title to trust assets, including its income, remained with the trustee, rather than the trust's beneficiaries. Because legal title to the trust's income remained with the trustee, and the beneficiaries had neither access to, nor control over the income, the trust and its beneficiaries are separate and distinct from each other, and should be treated as such for purposes of state income taxation of undistributed trust income.

Accordingly, it strains credulity to dispute that the trust was separate and distinct from its beneficiaries, and North Carolina's contentions to the contrary are devoid of merit.

II. Due Process Does Not Permit a State to Tax Undistributed Trust Income Based Solely on the Residence of a Discretionary Trust Beneficiary in the State.

The Question Presented addresses the extent to which the Due Process Clause permits North Carolina to tax undistributed income earned by a trust that is administered, and maintains all of its assets, books, and records, outside of North Carolina, based solely upon the North Carolina residence of discretionary trust beneficiaries to whom no trust distributions were made during the relevant tax years. As the Due Process Clause does not permit such state income taxation, the Court should affirm the decision of the court below.

Under the Due Process Clause, "[n]o State shall . . . deprive any person of life, liberty, or property, without due process of law[.]" U.S. Const. amend. XIV, § 1. The Court has interpreted the Due Process Clause to limit states' authority to tax, requiring a state to satisfy two jurisdictional prerequisites in order to impose tax on a prospective taxpayer. *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992), *overruled in part by South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2099 (2018). First, a state must show a "definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax". *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45 (1954). Second, the state must establish the existence of a rational relationship between income that the state seeks to tax and "values connected with the taxing [s]tate." *Quill*, 504 U.S. at 306; *F.W. Woolworth Co. v. New Mexico*, 458 U.S. 354, 365 (1982). Absent those two jurisdictional prerequisites, a state cannot tax a

prospective taxpayer in a manner that passes Due Process Clause-based muster.

Although a state may, at times, tax a prospective taxpayer that does not have a physical presence within the state's borders in a constitutionally-permissible manner, the state's authority to do so is subject to limitations. *Oklahoma Tax Comm'n v. Chicksaw Nation*, 515 U.S. 450, 463 n.11 (1995). One such limitation is the requirement that the prospective taxpayer "purposefully avail . . . itself of the benefits of an economic market in the forum [s]tate." *Quill*, 504 U.S. at 307. The underlying rationale is that a prospective taxpayer's purposeful availment puts the prospective taxpayer on notice that its "activity may subject [it] to the jurisdiction of a" state in which it does not have a physical presence. *Id.* at 308. The foregoing principles apply regardless of whether (a) the prospective taxpayer is an individual, a business entity, or a trust, or (b) the tax concerns income or sales tax.

In order for a state to tax income earned by a trust in a manner that comports with the Due Process Clause, the state must establish that the trust has a "definite link" and "minimum connection" to the state, and that a rational relationship exists between the trust income that the state seeks to tax and the values that the state provides. *Linn v. Ill. Dep't of Revenue*, 2 N.E.3d 1203, 1208 (Ill. App. Ct. 2013); *Residuary Tr. A v. Dir., Div. of Taxation*, 27 N.J. Tax 68, 72-76 (N.J. Tax Ct. 2013), *aff'd*, 28 N.J. Tax 541 (N.J. App. Div. 2015) (affirming on the basis of statutory construction, rather than the Due Process Clause). Failing such a showing, the Due Process Clause will bar state income taxation of a trust. *Linn*, 2 N.E.3d at 1208; *Fielding v. Comm'r of Revenue*, 916

N.W.2d 323, 329 (Minn. 2018), *petition for cert. pending*, No. 18-664 (filed Nov. 15, 2018).

A. A Discretionary Trust Beneficiary's Residence In a State Does Not Justify That State's Taxation of Undistributed Trust Income That Is Earned In Another State.

A state's taxation of undistributed income earned by a trust that is administered in another state, based solely on the presence of a trust beneficiary within the taxing state, is hardly a novel concept. *Brooke v. City of Norfolk*, 277 U.S. 27, 28-29 (1928). In fact, for the past 80 years, this Court has rejected states' efforts to tax undistributed trust income earned in another state where the taxing state's sole connection to the trust is the residence of a trust beneficiary in that state. *Id.*; *Safe Deposit & Tr. Co. v. Virginia*, 280 U.S. 83, 92 (1929). The Court has reasoned that a trust and its beneficiaries, though related, are not one and the same. *Safe Deposit*, 280 U.S. at 92 (explaining that, where the trustee of a trust owned legal title to trust securities in Maryland, and none of the trust beneficiaries located in Virginia had a "present right to their enjoyment or power to remove them," the "securities did not and could not follow any person domiciled in Virginia"); *cf. United States v. One Parcel of Prop. Located at Route 27, Box 411 (Patterson Road), Montgomery Cnty., Alabama*, 845 F. Supp. 820, 823-24 (M.D. Ala. 1993) (in rejecting the federal government's argument that a trust beneficiary's knowledge should be imputed to the trust's trustee in a forfeiture proceeding concerning the beneficiary, the court noted that a trustee's ownership of trust property "is independent of the beneficiary," and oftentimes requires the trustee to protect "the beneficiary from his or her own improvidence or incapacity").

Relying upon this Court's well-reasoned precedent, other courts (including state courts) have held that, under the Due Process Clause, the presence of a trust beneficiary in a particular state, without more, is insufficient to establish minimum contacts to justify the state's taxation of undistributed trust income that is earned in another state. *Mercantile-Safe Deposit & Tr. Co. v. Murphy*, 242 N.Y.S.2d 26, 28 (N.Y. App. Div. 1963) ("We find no merit . . . in their thesis that since the resident beneficiaries of the trust could be taxed on income distributed the nonresident trustee can be taxed on income accumulated."), *aff'd*, 203 N.E.2d 490, 491 (N.Y. 1964). For example, in *Mercantile-Safe Deposit & Trust Co. v. Murphy*, New York sought to tax the undistributed income earned by a trust administered in Maryland, by a corporate trustee based in Maryland, solely because a trust beneficiary resided in New York. *Id.* Citing to *Safe Deposit*, New York's Appellate Division and Court of Appeals rejected the state's argument, and held that regardless of the beneficiary's residence in New York, the tax violated the Due Process Clause. *Id.*[2]

A similar result is warranted when a state's only connection to a trust is a discretionary trust beneficiary's

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2. The holding the New York courts reached in *Mercantile-Safe Deposit & Trust Co.* is consistent with the one that this Court articulated in *Hanson v. Denckla*. In *Hanson*, this Court found that the presence of trust beneficiaries in Florida did not confer on that state jurisdiction over the trustee of a trust who had no other Florida connections. *Hanson v. Denckla*, 357 U.S. 235, 254 (1958). While North Carolina argues that *Hanson* has no application here because personal jurisdiction in litigation and tax jurisdiction are distinct concepts, this Court has recognized that adjudicative jurisdiction and tax jurisdiction are comparable with each other. *Quill*, 504 U.S. at 307-08.

residence within the state. Under such circumstances, insufficient contacts exist between the state and the trust to justify the state's taxation of the trust's undistributed income. *Potter v. Taxation Div. Dir.*, 5 N.J. Tax. 399, 405 (N.J. Tax Ct. 1983). This is because the discretionary trust beneficiary has "no right to the undistributed trust income." *Id.* Absent an exercise of discretion by the trustee, the discretionary trust beneficiary cannot access such undistributed trust income, direct that it be paid to (or for the benefit of) the beneficiary, or otherwise exercise control over it. Restatement (Second) of Trusts § 128, cmt. d.; *but cf. Linser v. Office of Attorney Gen.*, 672 N.W.2d 643, 646 (N.D. 2003) (explaining that a discretionary beneficiary's interests in a trust are too remote to warrant treating the trust's undistributed assets as belonging to the beneficiary).

Recognizing that the presence of discretionary trust beneficiaries within North Carolina was the only connection that the trust had to that state, the court below correctly concluded that the trust lacked sufficient minimum contacts with North Carolina to justify its tax on all of the income the trust earned during the 2005 to 2008 tax years. *Kimberly Rice Kaestner 1992 Family Tr. v. North Carolina*, 814 S.E.2d 43, 51 (N.C. 2018). The trustee resided in Connecticut. App. 40-41. The trustee maintained the trust's books and records in New York. *Id.* at 41. All of the trust's assets were in Massachusetts. *Id.* The trustee did not make distributions to any beneficiaries that were located in North Carolina, earn income within that state, or otherwise transact business in North Carolina. *Id.* at 41-42.

Simply put, since neither the trust nor the trustee engaged in any affairs in North Carolina, it cannot be said that Respondent purposefully availed itself of any benefits associated with North Carolina. What is more, because the trust's discretionary beneficiaries did not have a right to access or control the trust's assets or income, and those beneficiaries did not receive any trust distributions during the relevant tax years, the mere presence of Respondent's discretionary beneficiaries in North Carolina during those years is insufficient to establish the requisite minimum contacts to justify that state's tax on Respondent's undistributed trust income during the relevant tax years.

Putting aside, for argument's sake only, that the mere presence of a discretionary beneficiary of a trust in a particular state is insufficient to establish minimum contacts to justify that state's taxation of undistributed trust income that is earned outside of the state, such undistributed trust income also bears no relationship, rational or otherwise, to the values that the state in which the discretionary trust beneficiary resides provides to the trust. *Blue v. Dep't of Treasury*, 462 N.W.2d 762, 764 (Mich. Ct. App. 1990). Since none of the trustee, the trust's assets or the trust's income is located within North Carolina, the state provides "no ongoing protection or benefit to the trust." *Id.* The state is essentially a stranger to the trust, regardless of the state's relationship to a discretionary trust beneficiary. *Cf. Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 778 (1992) (noting that, to satisfy the Due Process Clause, "there must be a connection to the activity itself, rather than a connection only to the actor the [s]tate seeks to tax"). Consequently, the Due Process Clause does not permit North Carolina to tax the trust on undistributed income that the trust earned outside of North Carolina's borders.

North Carolina's reliance upon *Greenough v. Tax Assessors of City of Newport* for the proposition that "a trust constituent's residency in a state connects the trust to the state" is misplaced. Pet. Br. at 30. Although *Greenough* established that a state could constitutionally tax income earned by a trust based upon a trustee's presence within that state, *Greenough* does not support North Carolina's argument that a beneficiary's presence within the state provides the same jurisdictional basis. *Greenough v. Tax Assessors of City of Newport*, 331 U.S. 486, 493-96 (1947).

North Carolina's claim that *Greenough* is at odds with *Safe Deposit* is incorrect. First, it is worthy of note that the Court cited to *Safe Deposit* in *Greenough*, recognizing that the two cases involved different jurisdictional issues. *Greenough*, 331 U.S. at 496-97. On the one hand, the Court answered the jurisdictional question in *Safe Deposit* – whether the presence of trust beneficiaries in Virginia permitted that state to tax the trust's assets, even though the trustee, and the trust's assets, were located in Maryland – in the negative. *Safe Deposit*, 280 U.S. at 89-94. On the other hand, however, the Court answered the jurisdictional question in *Greenough* – whether the presence of a trust's trustee in Rhode Island authorized that state to tax the trust's intangible assets – affirmatively. *Greenough*, 331 U.S. at 488-98. Collectively, they provide that the presence within a state of a trust's trustee, but not a trust's beneficiary, is sufficient to establish minimum contacts with the state. Hence, *Safe Deposit* and *Greenough* are consistent with each other.

Finally, Petitioner's reference to *District of Columbia v. Chase Manhattan Bank, Chase Manhattan Bank*

v. Gavin, and *McCulloch v. Franchise Tax Board* is misplaced. All but one of the trusts in question in *District of Columbia* and *Gavin* were testamentary trusts, which were created pursuant to decrees that issued from courts in the jurisdictions that imposed tax. *District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539, 545 (D.C. 1997); *Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 795-99 (Conn. 1999). Although *Gavin* also concerned an inter vivos trust, the beneficiary thereof – whose presence in Connecticut was found to justify that state's taxation of the trust's undistributed income – had more significant vested rights in the *Gavin* inter vivos trust (including the right to receive the trust's corpus at age forty-five, and to direct how the trust's corpus would be distributed, if she died before attaining forty-five years of age) than Respondent's discretionary beneficiaries did in the trust established for their benefit. *Gavin*, 733 A.2d at 802. In *McCulloch*, California taxed the California-resident beneficiary of a Missouri testamentary trust for income earned during the last five years of the trust's administration, at a point when the trust already had terminated and its assets had been distributed to the beneficiary, which is readily-distinguishable from the present matter (in which Respondent's assets remained in trust during, and after, the relevant tax years). *McCulloch v. Franchise Tax Bd.*, 390 P.2d 412, 414-21 (Cal. 1964).

In light of the foregoing, the Due Process Clause does not permit a state to tax the undistributed income that a trust earns in another state, based solely upon the presence of a discretionary trust beneficiary within the taxing state. The court below correctly concluded as much in ruling for Respondent.

B. The Analysis of the Court Below Is Neither Formalistic Nor Rigid and Comports With the Due Process Clause.

Since deciding *International Shoe Co. v. Washington*, the Court has eschewed formalistic Due Process Clause tests that "focused on a [party's] 'presence' within a [s]tate in favor of a more flexible inquiry into whether [the party's] contacts with [a state] made it reasonable, in the context of our federal system of Government," to be taxed by the state. *Quill*, 504 U.S. at 307. Regardless of that flexibility, however, the Court has declined to abandon "the requirement that, in the case of a tax on activity, there must be a connection to the activity itself . . . " *Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 778 (1992). The Court has recognized that the Due Process Clause requires a connection to the activity that is taxed, not merely "to the actor [that] the [s]tate seeks to tax." *Id.*

North Carolina and certain *amici* assert that the North Carolina Supreme Court's holding was overly formalistic and rigid, in a manner that contravenes this Court's Due Process Clause precedents. Pet. Br. at 21-22; Br. for Minnesota and Nineteen Other States and the District of Columbia as Amicus Curiae Supporting Petitioner (hereinafter, the "States Amicus Br.") at 3-6. However, that argument fails because the income tax that North Carolina seeks to impose upon the trust's undistributed income bears no connection to activities that took place, or income earned, within North Carolina's borders. In effect, North Carolina impermissibly seeks to tax the trust based upon a connection not to the trust or the trustee, but rather to its beneficiaries, whose rights to access trust assets during the relevant tax years were subject to the trustee's absolute discretion. App. 42.

Minnesota, nineteen other states, and the District of Columbia advocate for the Court to adopt the Missouri Supreme Court's six-pronged test for determining whether a state can tax income earned by a trust. States Amicus Br. at 4. The six factors enumerated by the Missouri Supreme Court are: (1) "the domicile of the settlor"; (2) "the state in which the trust is created"; (3) "the location of the trust property"; (4) "the domicile of the beneficiaries"; (5) "the domicile of the trustees"; and (6) "the location of the administration of the trust." *Westfall v. Dir. of Revenue*, 812 S.W.2d 513, 514 (Mo. 1991). Under that test, when only one or two of the six factors are satisfied, the Due Process Clause cannot be met. *In re Swift*, 727 S.W.2d 880, 882 (Mo. 1987) (finding that Missouri could not impose income tax against a trust, even though the trust's settlor was domiciled in that state, and the trust was created there).

The test for which *amicus* advocates would not justify reversal here. Without more, the mere presence of a discretionary trust beneficiary in a particular state is insufficient to satisfy the Due Process Clause's requirement that a state have minimum contacts with a trust before taxing the trust's undistributed income. The presence of a trust beneficiary in a state is neither the dispositive factor that North Carolina claims it to be, nor one that warrants reversal here.

Contrary to the claims of North Carolina and certain *amici*, the North Carolina Supreme Court did not apply an antiquated, formalistic, or rigid Due Process Clause test in this matter. On the contrary, the court below properly recognized that North Carolina's efforts to tax undistributed trust income based solely upon the presence of discretionary trust beneficiaries within its borders

did not satisfy the Due Process Clause's requirement for minimum contacts.

C. The Court Below Did Not Create A Tax Shelter.

The states have adopted divergent approaches for taxing trust income. Seven states (Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming) do not tax trust income at all. Kevin R. Ghassomian, *Eliminate State Tax On Trust Income: A Comprehensive Update on Planning with Incomplete Gift Non-Grantor Trusts*, 39 ACTEC L.J. 317, 322 (Winter 2013). Although the remaining forty-three states and the District of Columbia do tax trust income, those jurisdictions apply different criteria in taxing income accumulated by trusts.

Only four states (California, Georgia, North Carolina, and Tennessee) tax income earned by trusts based upon the residence of a trust beneficiary within their borders. Cal. Rev. & Tax Code § 17742(a); Ga. St. § 48-7-22(a)(1)(c); N.C. Gen. St. § 105-160.2.; Tenn. Code Ann. § 67-2-110(a). Among the states in that small minority, Tennessee has repealed its state income tax, which will be fully phased out effective January 1, 2021. Tenn. Dep't of Rev., *2018 Guidance for Tennessee's Hall Income Tax Return* (July 12, 2017).

While the states are free to enact tax legislation of their choosing, that power is subject to limitations. *Greenough*, 331 U.S. at 493-95 ("But our question here is whether or not a provision of the Constitution forbids the tax. Neither the expediency of the levy nor its economic effect on the economy of the taxing state is for our consideration."). At the very least, the states must

comport with the Due Process Clause in enacting taxation legislation, which North Carolina failed to do here.

The Due Process Clause provides states with a wide array of options that do not raise constitutional concerns. Those options include: (1) taxing trust income that is derived from property and activity that takes place within a state; and (2) imposing tax on undistributed trust income earned by a trustee who is located in a state. Mich. Comp. Laws § 206.110; Ark. Code Ann. § 26-51-203(a)(1).

Yet another constitutionally-permissible option is available to states. States may tax accumulated trust income at the time that it is distributed to beneficiaries who are located within their borders, regardless of where the income is earned. N.Y. Tax Law § 612(b)(40); Cal. Rev. & Tax Code § 17745(b). When doing so, states receive the benefit of taxing resident trust beneficiaries, who receive trust distributions, for the accumulated income that the trusts earn during the years before distributions occur. Regardless of the contacts (or lack thereof) that the states have to trusts that are administered outside of their borders, states possess the minimum required contacts with trust beneficiaries who reside in the states and can tax such trust beneficiaries on accumulated trust income that is distributed to them without violating the Due Process Clause.

In light of the alternatives that are available to the states, it strains credulity to suggest that the analysis of the court below creates a tax shelter. Instead, as the North Carolina Supreme Court correctly recognized, a state can tax trust income, so long as the state satisfies the Due Process Clause's minimum contacts-based test,

which can be met by establishing that the trust's income arose from property or activities that occurred within the state, the trust's trustee was located in the state, or the trust's income was distributed to trust beneficiaries who resided within the state. Absent such a minimal showing, a state's taxation of trust income violates the Due Process Clause.

The Court's Commerce Clause-based analysis in *South Dakota v. Wayfair, Inc.* does not compel a contrary result. In *Wayfair*, the Court rejected the efforts of businesses that maintained no physical presence in particular states, but sold their goods and services to consumers located in those states via the internet, to avoid paying any sales tax to those states. In stark contrast to *Wayfair*, none of the parties to this proceeding argues that undistributed trust income is absolutely exempt from state income taxation in the absence of a physical presence of a trust within a state.

Rather, to the extent that a state's only connection with an out-of-state trust is a discretionary beneficiary's residence within the state, the state must await the beneficiary's receipt of trust distributions in order to tax trust income. Such a result fairly balances the state's interest in maximizing its tax revenues and the Due Process Clause's minimum-contacts analysis, by which all states are bound.

In light of the foregoing, North Carolina's tax on Respondent during the 2005 to 2008 tax years, which was predicated upon the residence of Respondent's discretionary trust beneficiaries in that state, violates the Due Process Clause. The Court should, therefore, affirm the North Carolina Supreme Court's decision.

III. North Carolina's Tax Violates the Commerce Clause.

Although the Question Presented concerns whether North Carolina's tax violates the Due Process Clause, Respondent argued below that the tax also violates the Commerce Clause. *Kimberly Rice Kaestner Family Trust v. North Carolina Dep't of Revenue*, 12-CVS-8740, 2015 WL 1880607 (N.C. Super. Ct. Apr. 23, 2015), *aff'd*, 789 S.E.2d 645 (N.C. Ct. App. 2016), *aff'd*, 814 S.E.2d 43 (N.C. 2018). While the North Carolina Business Court ruled that the law violated both the Due Process Clause and the Commerce Clause, North Carolina's Court of Appeals and Supreme Court only ruled that the statute violated the Due Process Clause. *Id.*, 814 S.E.2d at 47. Should the Court consider North Carolina's tax vis-à-vis the Commerce Clause, it should find that it is unconstitutional, or in the alternative, remand the matter.

A. The Four Factors For the Dormant Commerce Clause Analysis Cannot Be Met.

A state tax will survive scrutiny under the Dormant Commerce Clause so long as it: "(1) applies to an activity with a substantial nexus with the taxing State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services the State provides." *South Dakota v. Wayfair*, 138 S. Ct. 2080, 2091 (2018) (citing *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)).[3] An analysis of the tax under the

3. In finding that the tax ran afoul of the Commerce Clause, the North Carolina Business Court held that the tax did not satisfy the first or fourth prong, and did not address the other two prongs.

Complete Auto Transit test shows that North Carolina's tax does not fulfill any of these requirements, much less all of them.

The substantial nexus requirement commands that there be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344-45 (1954). For example, in the wake of *Wayfair*, Pennsylvania's intermediate appellate court rejected a Commerce Clause challenge to a Pennsylvania personal income tax upon non-resident taxpayers because the underlying entity derived its income from real property owned in Pennsylvania, which created a substantial nexus with the state. *Andrews v. Commonwealth of Pennsylvania*, 196 A.3d 1090, 1098 (Pa. Commw. Ct. 2018).

The operative activity – Respondent accumulating undistributed income – and the taxpayer (the trustee) did not create a nexus with North Carolina, much less a substantial nexus. The trustee did not live or work in North Carolina, none of the income was earned in North Carolina, and the trust did not own any assets in North Carolina. Nor was a cent distributed from the trust to anyone in North Carolina. The presence of discretionary beneficiaries in the State of North Carolina was incidental to the taxpayer's activities.

Kimberly Rice Kaestner Family Trust, 2015 WL 1880607, at *9. Specifically, the Business Court held that the discretionary beneficiaries' presence in North Carolina was "some contact" but hardly a "substantial nexus." Likewise, it found the taxpayer (the trustee) had no presence within the state.

Wayfair does not change this analysis. *Wayfair* dispensed with the physical presence requirement, dubbing it "artificial, anachronistic . . . unsound and incorrect." *Wayfair*, 138 S. Ct. at 2099. But this does not alter the outcome, as the state still must show that the tax is applied to an activity with a substantial nexus with the taxing state and that the taxpayer availed itself of the "substantial privilege" of conducting business in the jurisdiction. *Wayfair*, 138 S. Ct. at 2099. This is not the case here, as North Carolina's tax is designed to capture all income earned by a trustee, regardless of whether the trustee used or profited from any of North Carolina's services.[4]

Nor is the tax fairly apportioned. This prong of the *Complete Auto Transit* test serves to "ensure that each [s]tate taxes only its fair share of an interstate transaction." *Oklahoma Tax Com'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 184 (1995). Doing so requires analyzing whether the tax is both internally consistent and externally consistent. Internal consistency is achieved "when the imposition of a tax identical to the one in question by every other [s]tate would add no burden to interstate commerce that intrastate commerce would not also bear." *Jefferson Lines, Inc.*, 514 U.S. at 185. This Court described utility of this test three years ago in *Comptroller of Maryland Treasury v. Wynne*:

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4. For this reason, tax practitioners and commentators have speculated that *Wayfair* would have a minimal impact on state taxation of trusts. Richard W. Nenno, *Minimizing or Eliminating State Income Taxes on Trusts*, Koren Estate, Tax, and Personal Financial Planning Update (August 2018 ed.).

> By hypothetically assuming that every State has the same tax structure, the internal consistency test allows courts to isolate the effect of a defendant [s]tate's tax scheme. This is a virtue of the test because it allows courts to distinguish between (1) tax schemes that inherently discriminate against interstate commerce without regard to the tax policies of other [s]tates, and (2) tax schemes that create disparate incentives to engage in interstate commerce (and sometimes result in double taxation) only as a result of the interaction of two different but nondiscriminatory and internally consistent schemes. The first category of taxes is typically unconstitutional; the second is not.

Comptroller of Maryland Treasury v. Wynne, 135 S. Ct. 1787, 1802 (2015) (internal citations omitted).

If imposed nationwide, the North Carolina tax would discriminate against interstate commerce, as it would create double taxation upon any trust where the trustee resided in a state that taxed trust income, and a trust beneficiary, intentionally or not, resided in a different state.[5] In some instances, this would be unavoidable. As an illustration, consider a testamentary trust where the trustee had absolute discretion over distributing trust income, and a minor beneficiary resided in another state, and since she was a minor, could not relocate. Under the North Carolina law, the trustee would be subjected to

5. Subjecting interstate commerce "to the risk of a double tax burden to which intrastate commerce is not exposed" is forbidden by the Commerce Clause. *J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307, 311 (1938).

double taxation, and would be without recourse, as neither the trustee nor the beneficiary could relocate.[6]

This scheme would also create a sea change in trusts and estates practice for inter vivos trusts, as every time a beneficiary relocated to another state, grantors and trustees would be compelled to create a new trust (or decant a trust into a new trust) to avoid double taxation. Arguably, a trustee would be breaching its fiduciary duty if the trustee did not create a new trust (or decant).

The tax also fails to be externally consistent, which seeks "to discover whether a [s]tate's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing [s]tate." *Jefferson Lines, Inc.*, 514 U.S. at 185. As none of Respondent's activity occurred within North Carolina, the tax reaches beyond its permissible scope.[7] Additionally, as noted above, a blanket application of North Carolina's law exposes the taxpayer (the trustee) to multiple taxation if the trustee is also paying income tax to the state in which she resides.[8]

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6. This is why the tax also fails the third prong of *Wayfair* and *Complete Auto Transit*, as it is plainly discriminates against interstate commerce; here, there are a trustee and a trust beneficiary in different states.

7. Similarly, the tax fails the fourth prong of *Wayfair* and *Complete Auto Transit*, which requires that the tax bear some relation to the services provided by North Carolina. The services that North Carolina and its *amici* claim the state is providing (such as public education) are to the beneficiary, not the taxpayer.

8. "The threat of real multiple taxation . . . may indicate a state's impermissible overreaching." *Jefferson Lines*, 514 U.S. at 185; *see also J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307, 311 (1938).

B. In the Alternative, the Matter Should be Remanded for Commerce Clause Consideration.

In the event the Court reverses on Due Process grounds and does not hold that North Carolina's tax is unconstitutional under the Dormant Commerce Clause, it should remand for further proceedings to develop a record concerning whether the tax violates the Commerce Clause. For example, a tax will not be externally consistent when the taxpayer demonstrates "by clear and cogent evidence that the income attributed to the [s]tate is in fact out of all appropriate proportions to the business transacted in that [s]tate."[9] *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 170 (1983) (citing *Hans Rees' Sons v. North Carolina*, 283 U.S. 123 (1931)). The parties should be permitted to develop a record to ascertain whether this was the case.

Additional findings of fact would also be necessary to ascertain if North Carolina's tax poses an undue burden and violates the balancing test set forth *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). Indeed, this Court noted in *Wayfair* that *Pike* is one of several other aspects of Commerce Clause jurisprudence that can be used to ascertain a statute's constitutionality. *Wayfair*, 138 S. Ct. at 2098-99. The same is true as to whether North Carolina's tax impermissibly results in out-of-state taxpayers being subjected to double-taxation, whereas a domestic trust would not be. *See Wynne*, 135 S. Ct. at 1822.

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9. *Container Corp.* concerned an apportionment formula between two states. While this is not the case here, the overarching principle applies.

CONCLUSION

For the foregoing reasons, NYSBA respectfully submits that the decision below should be affirmed.

Respectfully submitted,

MICHAEL MILLER
President
ROBERT M. HARPER*
ANGELO M. GRASSO
JEFFERY H. SHEETZ
LOIS BLADYKAS
NEW YORK STATE BAR ASSOCIATION
One Elk Street
Albany, New York 12207
(518) 463-3200
rharper@farrellfritz.com

Counsel for Amicus Curiae

* *Counsel of Record*

No. 18-457

In The

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NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST,

Respondent.

On Writ of Certiorari to the Supreme Court of North Carolina

BRIEF FOR SOUTH DAKOTA AND ALASKA, NEVADA, AND TEXAS AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

JASON R. RAVNSBORG
South Dakota Attorney General
PAUL S. SWEDLUND*
MATTHEW W. TEMPLAR
Assistant Attorneys General
OFFICE OF THE SOUTH DAKOTA ATTORNEY GENERAL
1302 East Highway 14, Suite 1
Pierre, SD 57501-8501
(605) 773-3215
paul.swedlund@state.sd.us
**Counsel of Record*

Attorneys for Amici Curiae

March 25, 2019

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

QUESTION PRESENTED

May states, consistent with Due Process, tax the accumulated, undistributed gains of an out-of-state trust's assets because a trust beneficiary is a resident of the taxing state?

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INTEREST OF *AMICI CURIAE*

In a federal union, some states, a rural state such as South Dakota in particular, may find comparative economic advantage in not taxing personal and corporate income in the hope of attracting businesses to employ residents and support local communities through property and sales taxes. Admittedly, an incident of such a tax system is a favorable environment for trust location. Opening trusts to nationwide and multiple taxation will inevitably burden such interstate commerce by compelling trust constituents to confine their domiciles to one state whenever possible. Nationwide and multiple taxation also will subject resident South Dakota trusts to litigation in distant and inconvenient forums as states with resident grantors or beneficiaries sue one another over competing claims to their perceived taxable share of the trust *res*.

States have ways and means of taxing trust income without offending either Due Process or the Commerce Clause. A resident beneficiary may be taxed when a distribution is made; a resident trustee may be taxed for undistributed income; trust income may be taxed to the extent it is sourced to property or activity in the taxing state; or "throwback" provisions. As the plaintiff in *Wayfair*, South Dakota's *amicus curiae* interest is in seeing that further evolution of taxation jurisprudence remains tethered to legal and practical principles of Due Process.

SUMMARY OF ARGUMENT

Recently, *South Dakota v. Wayfair*, 138 S.Ct. 2080 (2018), abrogated the requirement that out-of-state retailers have a "physical presence" in a state in order to subject sales within that state to taxation. In

today's digital economy, where out-of-state retailers can establish an online "virtual presence"[1] anywhere and generate substantial sales to the detriment of local retailers, *Wayfair* dispatched the physical presence rule as a formalism of a bygone-era, overtaken by technology allowing out-of-state retailers to compute taxes due without burdening interstate commerce. Dispensing with physical presence essentially aligned the nexus component of Commerce Clause jurisprudence with Due Process concepts of minimum contacts.

North Carolina now invokes *Wayfair* to argue for abrogation of certain "formalisms" which prevent states from taxing accumulated, undistributed gains held in out-of-state trusts. The obstructing "formalisms" are a trust's independent legal identity and the assignment of the taxable situs of intangible assets to the jurisdiction where they are held. North Carolina proposes to dispense with these "formalisms" so that states may, in effect, pierce the fiduciary veil to directly tax in-state beneficiaries for undistributed gains realized by an out-of-state trust over which these beneficiaries exercise no control.

But this proposal demands more than dispensing with "obsolete formalisms." This proposal entails overturning at least two prior decisions of this Court and relaxing requisite Due Process contacts well below traditional minimums . . . to the end simply of substituting new formalisms – a grantor's or beneficiary's residence – for existing ones. These new formalisms, could not be adopted and applied to the trust industry without wholly abrogating customary constraints upon extraterritorial exercises of *in personam* or *in*

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[1] *Wayfair*, 138 S.Ct. at 2095.

rem jurisdiction. The trust industry, unlike the retail sector, has not experienced systemic structural changes warranting such radical reformulation of Due Process principles.

ARGUMENT

To paraphrase *Hanson v. Denkla*, 357 U.S. 235, 246 (1958), "[i]t is a mistake to assume that [*Wayfair*] heralds the eventual demise of all restrictions on the personal jurisdiction of state courts" over non-resident trust personnel or property. *Wayfair* simply relieved North Carolina of any need to demonstrate the Kaestner Trust's physical presence within its borders for purposes of meeting the substantial nexus component of the *Complete Auto*[2] test – *if* the Kaestner Trust's activities are interstate commerce. If not, North Carolina must satisfy *Quill's*[3] minimum contacts test. The North Carolina Supreme Court's *Kaestner* decision[4] and other briefing in this case ably describe why the Kaestner Trust's contacts with North Carolina satisfy neither test.

North Carolina faults the *Kaestner* court for reasoning that the trust's independent legal identity and situs of the trust's intangible assets in New York were critical to the disposition of that case.[5] To North Carolina, the trust's independent legal identity and taxable situs under traditional rules are archaic formalisms on a par with the physical presence rule

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[2] *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 285 (1977).

[3] *Quill v. North Dakota*, 504 U.S. 298 (1992).

[4] *Kaestner 1992 Family Trust v. North Carolina Dept. of Revenue*, 814 S.E.2d 43 (N.C. 2018).

[5] *Kaestner*, 814 S.E.2d at 49.

which should be abrogated as well. In lieu of these "old formalisms," North Carolina proposes a new formalism – taxation of a trust's accumulated gains by the beneficiary's state of residence (even if the beneficiary has no control over either the trust or its assets and has not realized any income from its accumulated gains). Other states pursue taxation through a different new formalism – the grantor's residency at the time of the trust's formation. North Carolina and other states take *Quill* and *Wayfair* to an extreme not warranted by currently applicable measures of extraterritorial jurisdiction, minimum contacts or traditional notions of justice and fair play.

Thus, there is significantly more at issue here than North Carolina's prescriptive jurisdiction to tax,[6] for prescriptive jurisdiction is hollow without the adjudicative jurisdiction to enforce it.[7] The "old formalisms" obstructing North Carolina's adjudicative jurisdiction exist to enforce constitutional constraints on extraterritorial exercises of *in personam* and *in rem*[8] jurisdiction, themselves rooted in imperatives of

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[6] *Quill*, 504 U.S. at 319-20 (Scalia, J., concurring)("It is difficult to discern any principled basis for distinguishing between jurisdiction to regulate and jurisdiction to tax"); Petitioner's Brief at 21 n. 9.

[7] *Safe Deposit & Trust Co. v. Commonwealth of Virginia*, 280 U.S. 83, 92 (1929)(prescriptive jurisdiction question ignored when taxing jurisdiction could not exercise adjudicative jurisdiction).

[8] *Connecticut General Life Ins. Co. v. Johnson*, 303 U.S. 77 (1938)("As a general principle, a state may not tax value earned outside its borders"); *Safe Deposit*, 280 U.S. at 93 ("A statute of a state which undertakes to tax things wholly beyond her jurisdiction or control conflicts with the Fourteenth Amendment . . . . [P]roperty permanently located beyond the owner's domicile may not be taxed at the latter place").

fundamental fairness. Precedent reveals that dispensing with these "old formalisms" likely would create "as many tax injustices as [this Court] would avoid."[9]

When, in *Brooke*, this Court recognized a trust's independent legal identity *vis-à-vis* a state's effort to directly tax a trust beneficiary it noted Fourteenth Amendment concerns with taxing trust property "to which she [wa]s a stranger" because, as here, the property was "not within the [taxing] state, d[id] not belong to the petitioner and [wa]s not within her possession or control."[10] *Greenough* reaffirmed that "[t]he legal interest of the trustee in the *res* is a distinct right."[11] And in *Hanson*, the "acts of the trustee," distinct and apart from those of the beneficiary, were determinative of jurisdiction. To the extent subsequent decisions have condoned certain exceptions to the general principle that a trust has an independent legal identity, they did so in response to circumstances not present here, such as one-time *estate* taxation in dual jurisdictions where a donor retained certain controls over the trust property,[12] or a taxed entity that was a "trust" in name only.[13]

When, in *Safe Deposit*, this Court assigned the taxable situs of intangible trust assets to the state where the assets were held in trust, it recognized the out-of-state trustee as "the holder of legal title" and the legal and physical separateness created by that

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[9] *Curry v. McCanless*, 307 U.S. 357, 373 (1939).

[10] *Brooke v. City of Norfolk*, 277 U.S. 27, 28 (1928).

[11] *Greenough v. Tax Assessors of City of Newport*, 331 U.S. 486, 495-96 (1947).

[12] *Curry*, 307 U.S. at 369 (1939).

[13] *Americold Realty Trust v. Conagra Foods, Inc.*, 136 S.Ct. 1012, 1016 (2016).

relationship.[14] *Safe Deposit* reasoned that it was the law of the situs state that "protected" the assets and that for a state to exercise *in rem* jurisdiction over trust property not subject to the control of the beneficiary and "wholly beyond [its] jurisdiction or control conflicts with the Fourteenth Amendment."[15] Such extraterritorial *in rem* jurisdiction in the trust context "would 'involve possibilities of an extremely serious character' by permitting double taxation, both unjust and oppressive."[16]

Today's "[f]lexible standards" of extraterritorial jurisdiction do not abrogate constraints on *in personam* or *in rem* jurisdiction over out-of-state trustees or trust property; these constraints must be overcome by a proper showing of sufficient minimal contacts between the legal titleholder of the trust *res* and a taxing state before an out-of-state trustee and trust property may be subject to extraterritorial taxation.[17] If overcoming these constraints was as easy as some "'random,' 'fortuitous,' or 'attenuated' contact" with a taxing state via the "unilateral activity" of a grantor or beneficiary in choosing to reside there,[18] operative protections of Due Process would lose all force in the trust context . . . and not just in regard to taxation.

The possibilities of tax injustices from unconstrained long-arm taxing statutes are manifold. As

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[14] *Safe Deposit*, 280 U.S. at 93.

[15] *Safe Deposit*, 280 U.S. at 92.

[16] *Safe Deposit*, 280 U.S. at 93.

[17] *Hanson*, 357 U.S. at 250-52.

[18] *Burger King v. Rudzewicz*, 471 U.S. 462, 475 (1985); *Hanson*, 357 U.S. at 250-52 (grantor's relocation to Florida after formation of trust not sufficient to create *in personam* jurisdiction over out-of-state trustee).

applied to trust beneficiaries, the term "undistributed income" is an oxymoron; trust gains are not "income" until they are paid to the beneficiary. A gain in a trust asset, *e.g.* a mutual fund, one year may be wiped out the next year. If taxed on this "gain" before it is paid as income, a beneficiary suffers the dual injustices of being taxed on a "gain" that subsequently evaporates and being forced to deplete the principal of the trust to pay the tax. Oppressive double or triple taxation could occur if, as here, a grantor created a trust in one state,[19] the trustee holds and manages the assets in another state, and a beneficiary lives in a third state – particularly if *each* state "tax[es] the entire net income of the trust" without apportionment for taxes imposed on other "trust constituents" in their respective states.[20] Such opportunities for multiple taxation inevitably will have a chilling effect on interstate commerce as trusts and beneficiaries consider consolidating their activities and holdings within a single state. Some states tax an out-of-state testamentary trust's income in perpetuity simply because the testator was domiciled in that state at the time of death years or decades

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[19] *District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539 (D.C.Ct.App. 1997)(statute permitting taxation of trust by District of Columbia because grantor formed the trust in the District of Columbia prior to his death); *Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999)(statute permitting taxation of trust by Connecticut because grantor formed trusts in Connecticut prior to his death).

[20] *McCulloch v. Franchise Tax Bd.*, 390 P.2d 412 (Cal. 1964) (statute permitting taxation of out-of-state trust by California because beneficiary was a California resident); *Fielding v. Commissioner of Revenue*, 916 N.W.2d 323 (Minn. 2018)(statute permitting taxation of out of state trust by Minnesota because beneficiary was a Minnesota resident); *District of Columbia*, 689 A.2d at 545 (asserting right to "tax the entire net income of the trust" because grantor died in the District over 50 years earlier).

ago.[21] Once grantor and beneficiary states begin suing each other for their perceived proportionate share of an out-of-state trust's annual accumulated gains, non-resident trustees inevitably will be haled into court in inconvenient forums in states that have provided no infrastructure or legal protection of service to the growth of trust assets.

The constitutional considerations attending exercises of extraterritorial *in personam* and *in rem* jurisdiction over out-of-state trustees and trust assets that animated this Court's decisions in *Safe Deposit, Greenough, Brooke* and *Hanson* are no less concerning now than then. At a minimum, these cases would have to be overruled in whole or in part, and a singular exception to general Due Process minimum contacts for trusts created, before North Carolina could visit any binding judgment on the New York trustee or trust assets in this case. But North Carolina has identified no "systemic and structural changes"[22] in the trust sector of the economy warranting such a radical reformulation of Due Process.

Indeed, the strained rationales required to sustain long-arm taxing statutes – which range from the merely paternalistic (beneficiary owes her "enjoy-

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[21] *District of Columbia*, 689 A.2d at 544, 545 (describing District of Columbia's "continuing jurisdiction" to tax NY trustee for income in 1987-1991 tax years because grantor was District resident in 1934 when he died); *Linn v. Department of Revenue*, 2 N.E.3d 1203, 1209 (Ill.App.4th 2013)(taxing trust created in 1961); *In re: Swift*, 727 S.W.2d 880 (Mo. 1987)(taxing trust created in 1942); *Gavin*, 733 A.2d at 787 (taxing trusts created in 1955 and 1968); *McNeil Trust ex rel. McNeil v. Commonwealth of Pennsylvania*, 67 A.3d 185 (Comm.Ct.Pa. 2013)(taxing trust created in 1959).

[22] *Wayfair*, 138 S.Ct. at 2097.

ment"[23] of life to the state) to the Orwellian (trust "owes its very existence"[24] to the state!!!) – reveal how "unacceptably grasping"[25] they are. The blessings of an orderly society bestowed by North Carolina on the Kaestners are not enjoyed by the Kaestner Trust or imputable to it for purposes of measuring the trust's contacts with the state.[26] *Wayfair* sustained South Dakota's sales tax because South Dakota had created a market in which Wayfair could operate and profit;[27] North Carolina's laws and markets contribute nothing to the Kaestner Trust's generation of income.[28] As in *Hanson*, "this suit cannot be said to be one to enforce an obligation that arose from a privilege [the Kaestner Trust] exercised in [North Carolina]" or any act by the trust to purposefully avail itself of the benefits and

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[23] *Gavin*, 733 A.2d at 802 ("social benefits" provided to beneficiary for "enjoyment" of her life in Connecticut, not trustee's connections to state, basis for directly taxing beneficiary for accumulated, undistributed trust gains); Petitioner's Brief at 36 (North Carolina make Kaestner's "lifestyle" possible).

[24] *District of Columbia*, 689 A.2d at 543; *Linn*, 2 N.E.3d at 1209 (fact that trust was formed under Illinois law – "owes its existence to Illinois" – more than 40 years earlier insufficient basis for taxation of out-of-state trustee).

[25] *Daimler AG v. Bauman*, 571 U.S. 117, 138 (2014); *Blue v. Department of Treasury*, 462 N.W.2d 762, 764 (Mich.App. 1990) (ostensible legal protections provided by state to non-resident trust "illusory").

[26] *Hanson*, 357 U.S. at 254 ("unilateral activity" of settlor in moving to Florida not imputed to defendant trustee).

[27] *Wayfair*, 138 S.Ct. at 2096; *Quill*, 504 U.S. at 328.

[28] *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 464 (1959)(taxes may be "levied only on that portion of the taxpayer's net income which arises from its activities within the taxing state"); *Quill*, 504 U.S. at 306 (taxed income must be rationally related to value provided by the taxing state).

protections of North Carolina's laws.[29] Rather, the Kaestner Trust's connections to North Carolina amount to nothing more than communicating with the beneficiary by mail or telephone while carrying out its general fiduciary responsibilities.[30]

Notions of fair play certainly have been abandoned when a state must accuse one of its citizens of freeloading to justify its aggressive taxing scheme. Petitioner's Brief at 34-36. It stands to reason that, since Kaestners took no distributions from the trust during the years in question, they earned their living from other income which North Carolina duly taxed as payment for the family's proportionate share of state services; the Kaestner Trust certainly made no quantifiable demands on North Carolina's infrastructure or resources. Thus, the *Wayfair* inequity of an out-of-state entity profiting from and consuming state resources without paying its fair share of taxes is not present here.[31]

Eleven states now have statutes or rules authorizing the taxation of trusts based on the residency of a beneficiary in the state.[32] Thirteen states authorize taxation based on the grantor's residency in the state.[33] Some courts have admirably held the constitu-

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[29] *Hanson*, 357 U.S. at 254; *Quill*, 504 U.S. at 307.

[30] *Quill*, 504 U.S. at 307; *Hanson*, 357 U.S. at 252 (settlor's "bits of trust administration" in her resident state of Florida did not render Delaware trustee to the jurisdiction of Florida courts).

[31] *Wayfair*, 138 S.Ct. at 2096.

[32] Alabama, California, Connecticut, Georgia, Michigan, Missouri, North Carolina, North Dakota, Ohio, Rhode Island, Tennessee.

[33] Delaware, Illinois, Maine, Maryland, Michigan, Nebraska, Oklahoma, Pennsylvania, Vermont, Virginia, Washington, D.C., West Virginia, Wisconsin.

tional line against the possible inequity and overreach of such statutes as applied to out-of-state trusts.[34] But not all have,[35] creating a "tangled underbrush"[36] of disparate taxation schemes and conflicting constitutional interpretations in need of clearing. Piercing the fiduciary veil as provided in these statutes risks "enmeshing courts in the 'perplexing' business, 'so unfit for the judicial department,' of attempting to delineate 'what degree of taxation is the legitimate use, and what degree of taxation may amount to the abuse of power.'"[37] Equally perplexing for courts will be valuing benefits allegedly conferred by taxing states on resident grantors, beneficiaries, trust entities and trustees and apportioning to such states their piece of the pie. Formalisms such as a grantor's or beneficiary's residency bear no relation to, indeed are antithetical to, Due Process constraints upon the exercise of extraterritorial jurisdiction over a trustee or trust *res*. Core principles of Due Process, not opportunistic new formalisms, must continue to govern the measure of a state's extraterritorial jurisdiction.

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[34] *Kaestner*, 814 S.E.2d at 49; *Linn*, 2 N.E.3d at 1209; *Fielding*, 916 N.W.2d at 331-32; *Blue*, 462 N.W.2d at 764; *Swift*, 727 S.W.2d at 882; *McNeil*, 67 A.3d at 193-96; *Kassner Trust v. New Jersey Division of Taxation*, 27 N.J.Tax 68 (Tax Ct.N.J. 2013); *Mercantile-Safe Deposit Trust Co. v. Murphy*, 203 N.E.2d 490 (Ct.App.N.Y. 1964).

[35] *Gavin*, 733 A.2d at 802; *District of Columbia*, 689 A.2d at 543; *Legg Irrevocable Trust v. Testa*, 75 N.E.3d 184 (Ohio 2016); *McCulloch*, 390 P.2d at 418.

[36] *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 445 (1940).

[37] *Dawson v. Steager*, 586 U.S. ____ (2019), quoting *McCulloch v. Maryland*, 4 Wheat. 316, 430 (1819).

CONCLUSION

While the fiduciary relationship may be an "abstraction," legal title to the property held by the trustee, and its power and control over assets bestowed by trust documents, are no mere legal fictions or "judicially-created tax shelters."[38] Hence, for jurisdictional purposes "[t]he citizenship of the trustee and not the seat of the trust or the residence of the beneficiary is the controlling factor." *Greenough*, 331 U.S. at 495-96. To pierce the fiduciary veil to directly tax a beneficiary on the undistributed gains of an out-of-state trust defeats all notions of fundamental fairness embodied in constitutional limits on the exercise of *in personam* and *in rem* jurisdiction over trustees and trust assets. This Court's retreat from the simple formalism of physical presence in *Wayfair* certainly did not portend such a radical departure from larger constitutional norms.

Respectfully submitted,

JASON R. RAVNSBORG
South Dakota Attorney General
PAUL S. SWEDLUND*
MATTHEW W. TEMPLAR
Assistant Attorneys General
OFFICE OF THE SOUTH DAKOTA ATTORNEY GENERAL
1302 East Highway 14, Suite 1
Pierre, SD 57501-8501
(605) 773-3215
paul.swedlund@state.sd.us
*Counsel of Record

Attorneys for Amici Curiae

March 25, 2019

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[38] *Greenough*, 331 U.S. at 493, 496-96 (legal interests of trustee distinct).

COUNSEL FOR ADDITIONAL *AMICI*

JAHNA LINDEMUTH
Attorney General
STATE OF ALASKA

AARON D. FORD
Attorney General
STATE OF NEVADA

KEN PAXTON
Attorney General
STATE OF TEXAS

No. 18-457

In the
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NORTH CAROLINA DEPARTMENT OF REVENUE,
Petitioner,

v.

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST,
Respondent.

On Writ of Certiorari to the Supreme Court of North Carolina

BRIEF OF TAX LAW PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

DANIEL J. HEMEL
UNIVERSITY OF CHICAGO LAW SCHOOL
1111 East 60th Street
Suite 610
Chicago, IL 60637

ERIK R. ZIMMERMAN
Counsel of Record
MARK A. HILLER
GABRIEL WRIGHT
ROBINSON, BRADSHAW & HINSON, P.A.
1450 Raleigh Road
Suite 100
Chapel Hill, NC 27517
(919) 328-8826
ezimmerman@robinsonbradshaw.com

Counsel for Amici Curiae

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INTEREST OF *AMICI CURIAE*[1]

Daniel Hemel is an Assistant Professor of Law at the University of Chicago Law School.

Brian Galle is a Professor of Law at the Georgetown University Law Center.

David Gamage is a Professor of Law at the Indiana University Maurer School of Law.

Michael Knoll is the Theodore K. Warner Professor of Law and Academic Director for Legal Education Programs at the University of Pennsylvania Law School, a Professor of Real Estate at the Wharton School, and Co-Director of the Center for Tax Law and Policy at the University of Pennsylvania.

Ruth Mason is the Class of 1957 Research Professor of Law at the University of Virginia Law School.

Adam Thimmesch is an Associate Professor of Law at the University of Nebraska College of Law.

Amici teach courses in tax law and write about constitutional issues affecting state taxation, and they have an interest in the sound development of this area. Institutional affiliations are provided for identification purposes only.

STATEMENT

This case presents a narrow but significant question at the intersection of state tax law and federal

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[1] Pursuant to this Court's Rule 37.3(a), *amici* state that all parties have granted blanket consent to *amicus* briefs. Pursuant to this Court's Rule 37.6, *amici* state that this brief was not authored in whole or in part by counsel for any party, and that no person or entity other than *amici* or their counsel made a monetary contribution intended to fund the preparation or submission of this brief.

constitutional law: whether the Due Process Clause of the Fourteenth Amendment prohibits a state from taxing its residents' proportionate share of the accumulated nonsource income of a nongrantor trust whose trustee resides in another state. That framing—though a mouthful—highlights several important aspects of the issue facing this Court.

First, only the taxation of *nongrantor* trusts is in dispute. If the grantor of a trust retains any one of several powers over the trust (*e.g.*, the power to revoke), and if the grantor can exercise that power without the approval of others who hold substantial beneficial interests in the trust, then the trust is treated as a "grantor trust" under federal tax law, and the grantor is treated as the "owner." *See* 26 U.S.C. §§ 672(a), 674-677. The trust's income and deductions are then included in computing the owner's taxable income. *Id.* § 671. In effect, the trust is "ignored" for income tax purposes. *See, e.g.*, *United States v. Buttorff*, 761 F.2d 1056, 1061 (5th Cir. 1985). North Carolina, like most other states, follows the federal grantor trust rules. *See* N.C. Gen. Stat. §§ 105-153.3(1), 105-153.4 (using federal tax law to calculate taxable income); N.C. Dep't of Revenue, *Grantor Trust Returns No Longer Required*, https://perma.cc/2G2J-F843 (explaining that grantor trusts need not file North Carolina income tax returns because their income is reported on the grantors' returns). The respondent trust is not a grantor trust because the grantor relinquished all relevant powers over the trust to the trustee. *See* App. 69.

Second, only the taxation of a trust's *nonsource* income is at issue. North Carolina, like other states with comprehensive income taxes, draws a distinction be-

tween income from in-state sources and all other income. A nongrantor trust's North Carolina source income—which includes income from real or tangible personal property inside the state, as well as income from a business, trade, profession, or occupation carried on in the state—is subject to North Carolina income tax regardless of whether the trust's beneficiaries are North Carolina residents. *See* N.C. Gen. Stat. § 105-160.2. For all other income, North Carolina taxes only its resident beneficiaries' proportionate share. *See id.* To protect against duplicative taxation of a trust's non-North Carolina source income, North Carolina allows a credit for income taxes paid to another state or country on income from sources in that jurisdiction. *See id.* § 105-160.4.[2] The respondent trust does not challenge North Carolina's authority to tax trust income from in-state sources, and it does not charge that North Carolina's system for crediting taxes paid to other jurisdictions is unfair or unconstitutional.

Third, the present controversy concerns only the taxation of a trust's *accumulated* income. When a trust earns income, it can either distribute the income to the beneficiaries immediately, or accumulate the income and add it to the trust principal. *See, e.g.*, *United States v. O'Malley*, 383 U.S. 627, 629 (1966). This Court decided nearly a century ago that the Due Process Clause permits a state to tax trust income distributed to a resident beneficiary, even when the

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[2] For example, if a trust whose beneficiaries are all North Carolina residents pays a tax to New York on rental income that the trust derives from a New York office building, the trust can claim a dollar-for-dollar credit against North Carolina income tax up to the amount of tax that North Carolina would otherwise impose on that income. *See* N.C. Gen. Stat. § 105-160.4(b).

trustee resides elsewhere and the income is from an out-of-state source. *See Maguire v. Trefry*, 253 U.S. 12, 17 (1920). The question in this case is whether the Due Process Clause requires a different result when, instead of distributing the income immediately, the trust accumulates the income for future distribution to the taxing state's residents.

The narrowness of this question should not obscure its importance. As of 2014, the most recent year with available data, more than 1.4 million "complex trusts" in the United States filed tax returns. *See* Internal Revenue Serv., Statistics of Income Div., *Fiduciary Income Tax Returns, Income Source, Deductions, and Tax Liability, by Type of Entity, Filing Year 2014* (Oct. 2015), https://www.irs.gov/pub/irs-soi/14fd02.xlsx. (A trust that accumulates income is a "complex trust."[3]) These trusts reported more than $90 billion in income from the previous year. *Id.* But even that figure understates the stakes, because a ruling for the respondent trust would encourage high-net-worth individuals to transfer many more billions of dollars to nongrantor trusts to avoid state income taxes. For that reason, this may well be the most important state income tax case that the Court has decided in decades, and its ramifications for state tax regimes will likely be felt for decades to come.

SUMMARY OF ARGUMENT

The Fourteenth Amendment's Due Process Clause prohibits a state from taxing the income of an

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[3] *See* 26 C.F.R. § 1.651(a)-(1). A trust also may be a "complex trust" if it distributes principal or makes charitable contributions. *See id.*; *compare* 26 U.S.C. § 651 (governing simple trusts), *with* 26 U.S.C. § 661 (governing complex trusts).

entity that has no connection to the state's residents. The Due Process Clause does not, however, prevent a state from taxing the income of an entity that directs all of its activities at the state's residents and that itself benefits from the state's protection and services. The court below misconstrued the Due Process Clause to do the latter, thereby transmogrifying the provision from a vital safeguard of fundamental rights into a recipe for avoidance of state income tax. Nothing in the text of the Fourteenth Amendment nor the century and a half of this Court's precedents construing it requires or recommends that result.

What the Due Process Clause does require are at least "minimum contacts" between a state and the object of its taxes. *See Quill Corp. v. North Dakota*, 504 U.S. 298, 307 (1992). "Minimum contacts" exist when the taxpayer's efforts are "purposefully directed" toward residents of the taxing state. *Id.* at 308 (internal quotation marks omitted). That is true here. The respondent is a trust, so *all* its efforts must be purposefully directed toward its beneficiaries, who are residents of North Carolina. *See* Restatement (Third) of Trusts § 78 (2007). It would be anomalous to say that a state has "minimum contacts" with a corporation that makes less than 0.5% of its sales to the state's residents, *see Quill*, 504 U.S. at 302, 308, but that a state lacks that requisite connection with a trust whose efforts must, by law, be aimed entirely at benefitting the state's residents.

This outcome accords with the "traditional notions of fair play and substantial justice" undergirding the Court's due process jurisprudence. *Quill*, 504 U.S. at 307 (internal quotation marks omitted). Here, North Carolina facilitates the respondent trust's accumulation of income by providing a wide range of services to

the trust's beneficiaries, thereby alleviating the trust's burden to pay for those same services itself. Meanwhile, a contrary holding that allowed a state to tax a nongrantor trust on its accumulated income only when the trustee is an in-state resident or the trust is administered inside the state would open a wide door to avoidance of state income tax. Financially sophisticated individuals who live in the 43 states that tax income could avoid current-year taxation of capital gains, dividends, and interest by transferring financial assets to nongrantor trusts in states that do not tax income, or in states that do not tax trust income on the basis of trustee residence or in-state administration. Those trusts could then strategically time their distributions to beneficiaries so as to minimize or eliminate any state-level taxation.

Perhaps this unattractive result would be acceptable—or at least inevitable—if it were a necessary prophylactic to protect interstate trusts from excessive taxation. But it is not. If this Court reverses the decision below, grantors and trustees still will be able to ensure that trust income is not subject to duplicative taxation on both the basis of beneficiary residence and the basis of trustee residence. And the Court's dormant Commerce Clause precedents establish additional guardrails that prevent states from taxing more than their fair share of trust income. *See, e.g.*, *Comptroller of the Treasury of Md. v. Wynne*, 135 S. Ct. 1787, 1803 (2015). The rigid rule applied by the court below—which prohibits a state from taxing any portion of a trust's nonsource income based on the in-state residence of trust beneficiaries—is gratuitous in light of these protections that interstate trusts already enjoy.

ARGUMENT

I. The Due Process Clause permits a state to tax income accumulating in a nongrantor trust for the benefit of its residents.

In a series of cases culminating in *Quill v. North Dakota*, this Court developed a two-pronged test to determine whether a state's exercise of its power to tax satisfies the Fourteenth Amendment's Due Process Clause. First, there must be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Quill*, 504 U.S. at 306 (quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-345 (1954)). This "definite link" requirement tracks the "minimum contacts" test familiar from the Court's personal jurisdiction cases. *See Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945). Second, the "income attributed to the State for tax purposes must be rationally related to values connected with the taxing State." *Quill*, 504 U.S. at 306 (internal quotation marks omitted).

These two prongs allow the Court to assess "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state." *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 25 (2008) (quoting *ASARCO Inc. v. Idaho Tax Comm'n*, 458 U.S. 307, 315 (1982)). They can be reduced to one "simple but controlling question": "whether the state has given anything for which it can ask return." *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 444 (1940).

Whether this Court applies *Quill*'s two-pronged test or *J. C. Penney*'s one-question approach, the same answer emerges: The Due Process Clause permits a

state to tax its residents' proportionate share of the accumulated nonsource income of a nongrantor trust.

A. A state tax on residents' proportionate share of trust income satisfies the "minimum contacts" and "rational relationship" requirements.

The court below concluded that North Carolina's application of its income tax to the respondent trust failed to meet the first prong of *Quill*: "minimum contacts" between the taxpayer and the taxing state. Pet. App. 10a, 18a. That conclusion was mistaken. In fact, the tax here satisfies both prongs of *Quill*.

1. A trust has more than "minimum contacts" with a state when all its activities are "purposefully directed" toward the state's residents.

A state's application of its tax satisfies the "minimum contacts" criterion when the taxpayer's "efforts are *purposefully directed* toward residents of [the taxing] State." *Quill*, 504 U.S. at 308 (emphasis added; internal quotation marks omitted). When a taxpayer purposefully directs its efforts toward residents of a particular state, the taxpayer cannot complain that it lacked "fair warning" of its possible obligations to that state. *See id.* And, in this case, there is no doubt that the respondent trust has purposefully directed its efforts toward residents of North Carolina.

The respondent trust, like any private (*i.e.*, noncharitable) trust, exists to benefit its beneficiaries. *See* Restatement (Third) of Trusts § 27 cmt. b (2003). The trustee "has a duty to administer the trust solely in the interest of the beneficiaries." *Id.* § 78(1). This duty applies to "all matters involving the administration of the trust and its property." *Id.* § 78 cmt. a; *accord*

Moeller v. Superior Court, 947 P.2d 279, 285 (Cal. 1997) ("A trustee must always act *solely* in the beneficiaries' interest."); George Gleason Bogert et al., *The Law of Trusts and Trustees* § 543 (2018) (trustee must "administer the trust solely in the interest of the beneficiary"). When, as here, all of the beneficiaries of a trust are residents of North Carolina, *see* Pet. App. 3a, it follows that the trust's activities are—and, by law, must be—"purposefully directed" toward residents of the state.

This conclusion aligns with the Court's due process cases. In *Quill*, there was "no question" that a company selling office equipment and supplies had "purposefully directed its activities at North Dakota residents" when it made less than 0.5% of its annual sales to North Dakota customers. *See* 504 U.S. at 302, 308. It would be anomalous to reach a different conclusion for the respondent trust when 100% of its activities are directed toward North Carolina resident beneficiaries.

This Court has likewise held that due process permitted a state to exercise jurisdiction over an out-of-state nonprofit membership association that provided sick benefits to the state's residents because the association "create[d] continuing relationships and obligations" with the state's citizens. *Travelers Health Ass'n v. Virginia*, 339 U.S. 643, 647 (1950); *see also Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 472-73 (1985) (citing *Travelers Health* as a case in which the purposeful direction requirement was satisfied). Here, by its nature, the respondent trust has "continuing relationships and obligations" with its North Carolina resident beneficiaries. Indeed, not unlike the membership association in *Travelers Health*, the trust in this case undertakes a duty to provide for the health of its

beneficiaries, among other ongoing obligations to ensure their well-being. App. 51.

Thus, as in *Quill*, there is "no question" that the taxpayer here has "purposefully directed" its activities toward residents of the taxing state, and that a "minimum connection" therefore exists between the taxpayer and that state. *Quill*, 504 U.S. at 306, 308; *see also id.* at 308 ("So long as a commercial actor's efforts are purposefully directed toward residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there." (quoting *Burger King*, 471 U.S. at 476)). North Carolina's application of its income tax to the respondent trust therefore satisfies the first prong of *Quill*.

2. A tax on residents' proportionate share of trust income is "rationally related" to values connected with the taxing state.

A state satisfies *Quill*'s second prong—a rational relationship between the income attributed to the state and values connected with the state, *see* 504 U.S. at 306—when, as here, the state taxes only the portion of a trust's income that is held for the benefit of in-state beneficiaries.

This Court "has refused to impose strict constitutional restraints on a State's selection of a particular formula" for attributing income to the state. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978). States instead have "wide latitude" on this issue. *Id.* at 274.

To be sure, states do not enjoy carte blanche: The Court will strike down an apportionment formula when the "income attributed to the State is in fact out of all appropriate proportion" to the values connected

with the state, or the state's approach "has led to a grossly distorted result." *Moorman*, 437 U.S. at 274 (internal quotation marks omitted). But there is no such problem here. North Carolina's approach for attributing trust income falls well within the "wide latitude" granted by the Court's due process cases.

North Carolina taxes trusts on "the amount of the taxable income of the estate or trust that is for the benefit of a resident" of the state. N.C. Gen. Stat. § 105-160.2. In other words, it attributes to itself the portion of the trust's nonsource income that corresponds to the interest of beneficiaries who reside in North Carolina. That means when, as here, all of the trust's beneficiaries reside in North Carolina, the state taxes 100% of the trust's nonsource income. *See* Pet. App. 3a. But if, for example, only 50% of a trust's beneficiaries reside in North Carolina, the state taxes only 50% of the trust's nonsource income.[4]

This attribution method is rationally related to values connected with North Carolina. *See Quill*, 504 U.S. at 306. Indeed, given that North Carolina taxes the non-North Carolina source income of a nongrantor trust only on the basis of beneficiary residence, it is difficult to imagine a more rational approach than also apportioning trust income based on the residence of the trust's beneficiaries. This approach attributes trust income to North Carolina on the same theory that permits North Carolina to tax trust income in the

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[4] The percentage of trust income subject to North Carolina tax should not be confused with the *rate* at which trust income is taxed. North Carolina's tax rate—for individuals as well as trusts—was 5.499% in 2017 and 2018, and 5.25% starting in 2019. *See* N.C. Gen. Stat. §§ 105-153.7(a), 105-160.2.

first place: the state's connection with the trust's beneficiaries.

B. A state's tax on its residents' share of trust income is justified by the benefits that the state provides to the trust.

The Court can arrive at the same result by applying the "simple" test of *J. C. Penney Co.*: "whether the state has given anything for which it can ask return." 311 U.S. at 444; *see also MeadWestvaco Corp.*, 553 U.S. at 24-25 (stating that the "broad inquiry" of *J. C. Penney* is "subsumed" in the *Quill* test). North Carolina "has given"—and continues to give—much to the respondent trust for which it can "ask return."

First, North Carolina makes possible the respondent trust's accumulation of income. The trust instrument here directs the trustee "to meet the needs of the Beneficiaries, including, without limitation, to provide for their health, education, and welfare." App. 51. Other trust instruments commonly invoke the phrase "health, education, support, or maintenance." *See, e.g.*, Bogert, *supra*, § 229 n.1; *id.* § 543 nn.31, 51; *see also* Restatement (Third) of Trusts § 50 cmt. d (2003). Under either of these formulations, the frequency and amount of a trust's distributions to the beneficiary depend inversely on the protections and services provided by the beneficiary's home state. For example:

- When a state provides world-class public universities and offers tuition discounts to its residents—as North Carolina does through the University of North Carolina, *see* N.C. Gen. Stat. §§ 116-1, 116-4, 116-144—the trust may be able to distribute less income to the beneficiary for her education than it otherwise would.

- When a state facilitates first-rate health care for its residents—which North Carolina does, among other ways, by establishing public health care entities such as the University of North Carolina Health Care System, *see* N.C. Gen. Stat. § 116-37—the trust may be able to distribute less income to the beneficiary for her health than if she had to travel to another state for care.
- When a state provides for the safety and security of its residents through police forces, fire departments, and emergency services, the state spares the trust the cost of attempting to replicate those protections and services for the beneficiary.

Second, North Carolina provides a forum in which certain trust-related disputes can be litigated. In *Greenough v. Tax Assessors of Newport*, 331 U.S. 486 (1947), this Court held that Rhode Island could—consistent with due process—tax the corpus of a trust where one of the trust's two trustees was a Rhode Island resident. The Court reasoned that the beneficiaries of the trust might have needed to proceed against the trustee in Rhode Island court, and that the trustee might have needed to invoke the jurisdiction of state courts on trust-related matters. *See id.* at 495. The Court therefore concluded that Rhode Island offered "benefit and protection through its law to the resident trustee," which was sufficient to support the state's tax. *See id.* at 496-97.

The reasoning of *Greenough* applies with similar force here. Just as Rhode Island's courts were open to the resident trustee, North Carolina courts are available to the constituents of the trust to resolve trust-related disputes.

For example, the trustee might need to invoke the jurisdiction of North Carolina courts to recover amounts improperly paid to a resident beneficiary. *See* Restatement (Second) of Trusts § 254 (1959); Restatement (Third) of Trusts § 104 cmt. g(3) (2012). Likewise, the North Carolina courts may be called upon to enforce the terms of a loan from the trust to a resident beneficiary. *See* Restatement (Second) of Trusts § 255 (1959); Restatement (Third) of Trusts § 104 cmt. d. And North Carolina courts may be the site of litigation when the trust or one of its beneficiaries alleges that another beneficiary has participated in a breach of trust. *See* Restatement (Third) of Trusts § 104 cmt. f.

Greenough observed that "[t]here may be matters of trust administration which can be litigated only in the courts of the state that is the seat of the trust." 331 U.S. at 495. But not all trust-related matters fall into that category, and the beneficiary's home state will be the appropriate forum for at least some cases. If the possibility that Rhode Island's courts would be called upon to adjudicate trust-related disputes was sufficient to justify a tax on the trust in *Greenough*, then the possibility that North Carolina's courts may be called upon to do the same is sufficient for tax jurisdiction here.

Third, the protection and services that North Carolina provides to its resident beneficiaries enhance those beneficiaries' present and future enjoyment of trust income—and therefore advance the respondent trust's purpose of benefitting the beneficiaries. That is undoubtedly true when the trust distributes income to the beneficiaries. *See Maguire*, 253 U.S. at 17. But it is also true when the trust accumulates income for the beneficiaries. For example:

- The trust may lend accumulated funds to a beneficiary on more favorable terms than the beneficiary could secure from a commercial lender. *Cf.* App. 100 (testimony by trustee that he lent funds to Ms. Kaestner and her husband at "a low interest rate" so that they could "invest in vanilla").
- Knowing that the trust has accumulated income for her health, education, and welfare may allow a beneficiary to pursue business and investment opportunities that—if not for the fallback provided by the trust—would be too risky.
- Likewise, the financial security provided by the trust may allow a beneficiary to save less year-to-year—and to allocate more of her own income toward consumption—than if she lacked the safety net that the trust supplies.

A beneficiary is in a position to invest and consume in these ways, and thus to enjoy the benefits of the trust's accumulated income, only because her home state provides basic protections for her health, safety, and welfare, including "police and fire departments," "public roads and municipal services," and "sound local banking institutions." *See South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2096 (2018) (internal quotation marks omitted). A tax on the trust's accumulated income therefore "bears fiscal relation to protection, opportunities, and benefits given by the taxing state." *MeadWestvaco*, 553 U.S. at 25; *ASARCO*, 458 U.S. at 315; *J. C. Penney*, 311 U.S. at 444.

C. None of the Court's previous trust taxation cases bars a state from taxing its residents' share of trust income.

Contrary to respondent's argument in opposing certiorari, *see* Opp. 29, the Court did not resolve the question presented by this case in *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83 (1929). *Safe Deposit* concerned a tax assessed by Accomac County, Virginia, on personal property held by a trustee in Maryland for beneficiaries in Virginia. *See* 280 U.S. at 90-91 & n.1, 93-94. *Safe Deposit* did not concern an *income* tax, and thus did not address the question here: whether a state can tax income accumulated by a trust for the benefit of the state's residents.

An analogy illustrates the point. Connecticut towns impose an annual tax on motor vehicles. Conn. Gen. Stat. § 12-71(f). The tax is based on the vehicle's location: The tax is due to the town "where such vehicle in the normal course of operation most frequently leaves from and returns to or in which it remains." *Id.* § 12-71(f)(2)-(3). Connecticut also imposes a tax on the income of its residents, regardless of where that income is earned. Conn. Gen. Stat. §§ 12-700, 12-701(1), (19), (20).

Now imagine that a resident of Greenwich, Connecticut, owns a fleet of New York City taxi cabs, all of which operate inside New York City limits. The Town of Greenwich would not impose its motor vehicle tax on those cabs (and, as a constitutional matter,

probably could not do so),[5] but the State of Connecticut could and would impose its income tax on the Greenwich resident's income from the cabs.

Safe Deposit pertains to the imposition of property tax on a trust's out-of-state personal property. As applied to this example, it would mean that Connecticut towns could not impose their motor vehicle tax on a trust's New York City-based taxi cabs. The question that would be analogous to the actual question before the Court in this case, in contrast, would be whether Connecticut could apply its income tax to a trust's earnings from its New York City taxi cab business. *Safe Deposit* does not address that question.[6]

For the same reasons, the North Carolina Court of Appeals erred in concluding that *Brooke v. City of Norfolk* "controls the analysis and outcome" of this

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[5] Most glaringly, the tax would—without further modification—flunk the Court's "internal consistency" test unless the state offered relief to residents who pay motor vehicle taxes to other jurisdictions or to nonresidents who own vehicles in Connecticut. *See Wynne*, 135 S. Ct. at 1805-06.

[6] North Carolina persuasively argues that this Court's subsequent cases have repudiated *Safe Deposit*. *See* Br. of Pet'r 27-28 & n.12. *Amici*'s argument is not that *Safe Deposit* should be reaffirmed; it is, rather, that *Safe Deposit* is inapposite. As a practical matter, the limits imposed by *Safe Deposit* on a state's authority to tax a trust's out-of-state property are much less relevant today than 90 years ago because personal property taxes comprise a dwindling share of state tax revenue. *See* John L. Mikesell, *Patterns of Exclusion of Personal Property from American Property Tax Systems*, 20 Pub. Fin. Q. 528, 530 (Sage 1992). Meanwhile, more than half of the states have adopted income taxes in the years since *Safe Deposit*. *See* Scott Drenkard & Richard Borean, *When Did Your State Adopt Its Income Tax?*, Tax Found. (June 10, 2014), https://perma.cc/C3V3-LACK.

case. *See* Pet. App. 38a-39a (citing *Brooke v. City of Norfolk*, 277 U.S. 27 (1928)). *Brooke* presented the same basic question as *Safe Deposit*: whether the City of Norfolk could apply a personal property tax to property held by a trustee in Maryland—in fact, the same trustee as in *Safe Deposit*—for a beneficiary in Virginia. *See* 277 U.S. at 28. In *Brooke*, the city attempted to collect the property tax from the beneficiary, *see id.*, whereas in *Safe Deposit*, the county attempted to collect the property tax from the trustee, *see* 280 U.S. at 90, 93. But that distinction made no difference to the result—*Brooke* also held that the Virginia property tax could not be imposed on property in Maryland. *See* 277 U.S. at 28.

Because *Brooke*, like *Safe Deposit*, concerned a tax on a trust's out-of-state property, it did not address the question presented here: whether a state can apply its income tax to trust income held for an in-state beneficiary. The Court of Appeals was therefore mistaken in reading *Brooke* to be outcome-determinative.

II. A ruling for the respondent trust would open up a "judicially created tax shelter" of *Quill*-like proportions.

As emphasized in Part I, North Carolina has the better of the doctrinal argument here, and that is all that the Court need consider in resolving this case. If the doctrine were in any doubt, however, the unappealing practical consequences of the rule advocated by the respondent trust should give the Court pause before adopting it.

Different states use different standards to determine a trust's residence for income tax purposes, but all states that tax trust income use at least one of four criteria: the residence of the beneficiary, the residence

of the grantor (*i.e.*, the testator of a testamentary trust or the settlor of an *inter vivos* trust), the residence of the trustee, or the place of trust administration. *See* Richard W. Nenno, *Minimizing or Eliminating State Income Taxes on Trusts—Part One*, West's Est., Tax, & Pers. Fin. Plan., at 7 (May 2018) ("Nenno, *Part One*"), https://perma.cc/BJ4K-NWHZ. A majority of these states tax trust income on the basis of grantor residence, beneficiary residence, or some combination of the two. *See id.* at 7-10. Respondent argues here that the Due Process Clause prohibits a state from taxing trust income on the basis of beneficiary residence, and it has argued previously that taxation of trust income on the basis of grantor residence would violate the Due Process Clause as well. *See* App. 78. That leaves the trustee's state of residence and the situs of trust administration as the remaining bases upon which respondent's approach would allow a state to tax a trust's nonsource income.

These criteria—the residence of the trustee and the place of trust administration—are the easiest for taxpayers and their advisors to manipulate. *See* Richard W. Nenno, *Minimizing or Eliminating State Income Taxes on Trusts—Part Three*, West's Est., Tax, & Pers. Fin. Plan., at 10 (July 2018) ("Nenno, *Part Three*"), https://perma.cc/BJ4K-NWHZ; *see also Greenough*, 331 U.S. at 493 ("The trustee of today moves freely from state to state."). Indeed, respondent's rule would make it straightforward for individuals to escape state income tax on capital gains, dividends, and interest. An individual could set up a trust with a provider in one of the seven income-tax-free states—or any other state that does not tax trust income on the basis of trustee residence or place of administration—and then transfer assets to that trust.

If the trust already exists and is administered in a state with an unfavorable tax regime, the grantor or beneficiaries could choose a new trustee in a more tax-friendly jurisdiction. By sharing control over the trust with family members, the grantor would ensure that the trust is treated as a nongrantor trust. *See* Jeffrey Schoenblum, *Strange Bedfellows: The Federal Constitution, Out-of-State Nongrantor Accumulation Trusts, and the Complete Avoidance of State Income Tax*, 67 Vand. L. Rev. 1945, 1948 (2014). Capital gains, dividends, and interest generated by trust assets would vanish from the tax base of the grantor's and beneficiaries' home states.

Few barriers would stand in the way of taxpayers seeking to execute this state tax avoidance strategy. The grantor's transfer of assets to the trust would not trigger gift tax in 49 out of 50 states.[7] Transfers of up to $11.4 million for an individual ($22.8 million for a married couple) would not result in federal gift tax under current law. *See* 26 U.S.C. § 2505(a) (same exclusion applies to estate tax and *inter vivos* gifts); Internal Revenue Serv., Rev. Proc. 2018-57, § 3.41 (Nov. 17, 2018) (estate tax exclusion for 2019 is $11.4 million). For transfers above that amount, the taxpayer could establish an "incomplete gift nongrantor trust," which is treated as a nongrantor trust for income tax purposes but as part of the grantor's estate for gift and estate tax purposes. *See* Schoenblum, *supra*, at 1963-67. In practice, a motivated taxpayer could eliminate income tax in her home state on virtually all capital gains, dividends, and interest income. All the while,

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[7] Connecticut is the only state that imposes a comprehensive gift tax. *See* Bogert, *supra*, § 300.

the trust could issue low-interest-rate loans to beneficiaries, allowing them to benefit from the trust's accumulated income without paying state income tax. The trust could defer repayment until the beneficiary relocates to a tax-free state or moves into a lower tax bracket, at which point the trust could make a distribution to the beneficiary equal to the amount owed.

The revenue consequences for state governments would be profound. The taxpayers most likely to shift assets into nongrantor trusts under a ruling for the respondent trust are the ones with the highest incomes, for whom the potential state tax savings justify the administrative expenses. The assets that they are most likely to shift are those that generate capital gains, dividends, and interest, which in most cases will be treated as nonsource income. In filing year 2017, according to Internal Revenue Service statistics, the roughly 9000 households in North Carolina with more than $1 million in adjusted gross income reported a total of $8.1 billion in capital gains, dividends, and taxable interest. *See* Internal Revenue Serv., Statistics of Income Div., *Individual Income Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2016: North Carolina* (Aug. 2018), https://www.irs.gov/pub/irs-soi/16in34nc.xls. These sources accounted for more than a third of all income reported by that group. *See id.* With a flat state tax rate at the time of 5.499%, *see* N.C. Gen. Stat. § 105-153.7(a), those taxpayers would have paid more than $440 million on that income.

To put these figures in perspective: A Government Accountability Office report cited by the Court in *Wayfair* estimated that, if *Quill*'s dormant Commerce Clause holding were overruled, North Carolina's potential revenue gain would have been between $223

million and $358 million in 2017. *See* U.S. Gov't Accountability Office, GAO-18-114, *Sales Taxes: States Could Gain Revenue from Expanded Authority, but Businesses Are Likely to Experience Compliance Costs*, app. II, at 48 (2017) (cited at *Wayfair*, 138 S. Ct. at 2088). Although a ruling for respondent here would not lead high-income households in North Carolina to shift *all* of their financial assets to nongrantor trusts administered in other states, the revenue consequences are potentially on the same order of magnitude as the stakes in *Quill*.

Beyond its revenue impacts, respondent's rule would have disturbing distributional implications. The winners would be the wealthy, who—again—can afford the fixed costs of establishing and maintaining nongrantor trusts and who hold financial assets that they can shift to those trusts. The losers would be lower- and middle-income taxpayers whose earnings come primarily from in-state sources such as salary, wages, and self-employment.[8] These taxpayers would likely end up shouldering more of the state income tax burden as wealthy households bore less. Funding for public schools, public health, law enforcement, and other essential state and local government services would suffer as well.

These consequences are far from hypothetical. Tax practitioners are already citing decisions such as the one below when describing ways for their high-

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[8] For North Carolina households with adjusted gross income under $1 million, the combination of salaries, wages, and business and professional income constitutes approximately 80% of total income, while capital gains, dividends, and taxable interest account for less than 5%. *See* Internal Revenue Serv., Statistics of Income Div., *Individual Income Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2016: North Carolina*, *supra*.

net-worth clients to dramatically reduce state income tax liability. *See, e.g.*, Nenno, *Part Three* at 4-5 (citing *Kaestner*); Steve Hartnett, *State Income Taxation of Nongrantor Trusts*, Am. Acad. of Estate Planning Attys. (Feb. 5, 2019), https://perma.cc/L9XK-7F28 (same); Melissa M. Price, *Constitutional Challenges to State Income Taxation of Trusts*, Wealth Mgmt., 2019 WLNR 2546751 (Jan. 25, 2019) (same); Jordan D. Veurink, *Practical Pointers from Practitioners, Recent Resident Trust Rulings: Can Your Clients' Trusts Avoid State Income Tax?*, 33 Probate & Property 55 (Jan./Feb. 2019) (same). These practitioners are by no means skirting ethical lines by advising clients to pursue these strategies. They are simply guiding their clients through a loophole that decisions like the one below have opened.

To be sure, taxpayers have used trusts to reduce state income tax for decades. *See* Robert H. Sitkoff & Max M. Schazenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 Yale L.J. 356, 420 (2005). Yet three recent developments make the problem particularly acute today.

First, the doubling of the estate and gift tax exclusion as part of the December 2017 tax law means that individuals can now transfer twice as much wealth to trusts administered in other states before federal gift taxes even come into the picture. *See* Pub. L. No. 115-97, § 11061, 131 Stat. 2054, 2091 (2017) (amending 26 U.S.C. § 2010(c)).

Second, the IRS rulings that effectively allow taxpayers to make unlimited gift-tax-free transfers to certain nongrantor trusts were not issued until 2013. *See, e.g.*, Internal Revenue Serv., P.L.R. 201310002

(Mar. 8, 2013); Schoenblum, *supra*, at 1967 n.81 (compiling relevant rulings).

And *third*, the new $10,000 limit on the federal income tax deduction for state and local taxes—included in the December 2017 tax law—enhances the impetus for high-income taxpayers to reduce their state tax bills. *See* Pub. L. No. 115-97, § 11042, 131 Stat. at 2085-86 (amending 26 U.S.C. § 164(b)); Nenno, *Part One* at 5 ("Structuring a nongrantor trust to eliminate state income tax entirely can help an individual to preserve th[is] deduction.").[9]

Whatever one thinks of these developments individually, they interact with the decision below to make avoidance of state income tax through the use of nongrantor trusts both more feasible and more attractive. *See, e.g.*, Hartnett, *supra* (observing that "*Kaestner* could simplify th[e] process" for taxpayers who seek to "avoid state income taxation" through the use of nongrantor trusts).

Just last year, this Court recognized that its dormant Commerce Clause holding in *Quill* had "come to serve as a judicially created tax shelter" of multibillion-dollar proportions. *Wayfair*, 138 S. Ct. at 2088, 2094. *Stare decisis* notwithstanding, the Court shut that shelter down. *See id.* at 2096-99. It would be both ironic and unfortunate if only a year later, the

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[9] The changes in the December 2017 law mean that top-bracket taxpayers who previously bore an after-federal-tax cost of 60.4 cents for every dollar they paid in state income tax now generally incur an after-federal-tax cost of 100 cents on the dollar. The all-in cost of state taxes (including the effect on federal income tax liability) has thus increased by approximately two-thirds.

Court erected a new shelter—with proportions potentially similar to those in *Quill*, but with none of the same precedential pedigree.

III. Interstate trusts retain protection from unduly onerous tax burdens.

The practical consequences of ruling for North Carolina in this case would be far less troubling. Although allowing states to tax trust income on the basis of beneficiary residence could conceivably give rise to double taxation in some circumstances, trusts and their grantors would be able to shield themselves from duplicative state taxes in the mine run of cases.

First, any grantor can easily avert an outcome in which a trust that she settles is subject to tax on the basis of beneficiary residence in one state and trustee residence in another. She "can avoid piling on state income taxes" by choosing to have her trust administered in—and by a resident of—a state that does not tax trust income based on the place of administration or the residence of the trustee. *See* Sitkoff & Schazenbach, *supra*, at 386. Unsurprisingly, recent years have seen a migration of trust funds toward states that do not tax trust income on those bases. *See id.* at 420.

Second, as discussed above, prong two of the due process test in *Quill* requires a rational relationship between the income that a state taxes and the values connected to the state. *See Quill*, 504 U.S. at 306. And while that requirement is easily satisfied here, it would nonetheless stand in the way of a disproportionate state tax on trust income. For example, if a state sought to tax 100% of trust income based on the fact that 50% of the trust's beneficiaries were residents of the state, then the state's regime would clearly fail *Quill*'s second prong.

Third, almost all states with income taxes of their own follow the federal grantor trust rules. *See* Nenno, *Part One* at 7. In most cases, therefore, a grantor who establishes a grantor trust (*e.g.*, by retaining the power to revoke, *see* 26 U.S.C. § 676) can ensure that—at least during her own lifetime—trust income will be subject to state tax only once: in the grantor's home state.

Fourth and finally, the Court's dormant Commerce Clause cases impose constraints on state tax authority over and above the requirements of due process. *See Wynne*, 135 S. Ct. at 1799 (observing that the cases are "[l]egion" in which the Court has considered and sustained dormant Commerce Clause challenges to state taxes that otherwise satisfy the due process criteria). Perhaps most relevant to the issue of overlapping state taxation of trusts, the Court has held that state tax regimes must satisfy the requirement of "internal consistency." *See id.* at 1802-03 (collecting cases). "To be internally consistent, a tax must be structured so that if every State were to impose an identical tax, no multiple taxation would result." *Goldberg v. Sweet*, 488 U.S. 252, 261 (1989).

Consider, hypothetically, a state that taxes 100% of trust income when all the beneficiaries reside in the state *or* the trustee resides in the state. This tax would flunk the internal consistency test. If every state were to adopt this tax scheme, interstate trusts would be disfavored: A trust whose trustee and beneficiary reside in the same state would be taxed once, but a trust whose trustee and beneficiary reside in different states would be taxed twice. States must therefore choose between trustee or beneficiary residence as their basis for trust taxation—or, if they choose both,

must allow a credit for trust income taxes paid to other states.

North Carolina's trust taxation regime appears to satisfy the internal consistency test because the state taxes the nonsource income of trusts only on the basis of beneficiary residence, not on the basis of grantor or trustee residence. And while North Carolina taxes all trusts on their income from in-state sources, it provides a corresponding credit for source taxes paid to other states. *See* N.C. Gen. Stat. §§ 105-160.2, 105-160.4. So if every state adopted North Carolina's regime, there would be no impermissible double taxation of trust income. The North Carolina Supreme Court did not reach respondent's dormant Commerce Clause challenge, however, and the case should be remanded so that the North Carolina courts can address that question in the first instance.[10]

In sum, the potential for overlapping taxes on trust income does not justify a ruling for respondent here. It is true that some amount of "double taxation" will occur at the state level unless this Court mandates that all states adopt identical tax bases. *See Moorman*, 437 U.S. at 279 ("The prevention of duplicative taxation . . . would require national uniform rules for the division of income."). But such "double taxation" does not itself violate the Due Process Clause, *see Curry v. McCanless*, 307 U.S. 357, 372-73

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[10] The trial court did reach the dormant Commerce Clause challenge, and agreed with the respondent trust that North Carolina's tax violates the dormant Commerce Clause. But that conclusion was based on the trial court's determination that North Carolina neither had a sufficient connection to the trust nor provided any benefits to the trust. *See* Pet. App. 63a-68a. That determination is erroneous for the same reasons discussed in Part I of this brief.

(1939), or the dormant Commerce Clause, *see Wynne*, 135 S. Ct. at 1802, 1804. And, in any event, the remedies already available to trusts and their grantors considerably reduce the risk of duplicative tax burdens. Where the choice is between double taxation of a small slice of trust income and "nowhere taxation" of a massive chunk, concerns about occasional overlap among state tax claims should not drive the result.

CONCLUSION

The judgment of the Supreme Court of North Carolina should be reversed.

Respectfully submitted,

DANIEL J. HEMEL
UNIVERSITY OF CHICAGO
LAW SCHOOL
1111 East 60th Street
Suite 610
Chicago, IL 60637

ERIK R. ZIMMERMAN
Counsel of Record
MARK A. HILLER
GABRIEL WRIGHT
ROBINSON, BRADSHAW &
HINSON, P.A.
1450 Raleigh Road
Suite 100
Chapel Hill, NC 27517
(919) 328-8826
ezimmerman@robinson
bradshaw.com

Counsel for Amici Curiae

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No. 18-457

IN THE
Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,
Petitioner,

v.

THE KIMBERLEY RICE KAESTNER
1992 FAMILY TRUST,
Respondent.

On Writ of Certiorari to the Supreme Court of North Carolina

BRIEF FOR *AMICI CURIAE* WASHINGTON STATE TAX PRACTITIONERS IN SUPPORT OF RESPONDENT

Dirk Giseburt*
Davis Wright Tremaine LLP
920 Fifth Avenue
Suite 3300
Seattle, WA 98104
(206) 757-8049
dirkgiseburt@dwt.com

Counsel for *Amici Curiae*
*Counsel of Record

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QUESTION PRESENTED

Does the Due Process Clause prohibit states from taxing trusts based solely on trust beneficiaries' in-state residency?

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BRIEF OF *AMICI CURIAE* WASHINGTON STATE TAX PRACTITIONERS IN SUPPORT OF RESPONDENT

INTEREST OF THE *AMICI CURIAE*

Amici curiae ("Practitioners")[1] are lawyers practicing state and local tax law and trust and estates law in Washington State. Practitioners regularly apply this Court's Due Process Clause and Commerce Clause precedents in the representation of U.S. and foreign individuals, families, charities, and business organizations of every kind. Others are regularly engaged in advising clients about their options in the structuring of trusts and related tax consequences at the state and federal levels.

Practitioners join this brief solely as individuals and not as representatives of the law firms or associations with which they are affiliated. Each Practitioner is currently in private practice. Among them are Practitioners who are Fellows of the American College of Trust and Estate Counsel; who have taught state and local taxation or estate planning at the University of Washington School of Law; who have served in the past as President or Treasurer of the Washington State Bar Association; or

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[1] No counsel for a party authored this brief in whole or in part, nor made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amici curiae* or its counsel made a monetary contribution to its preparation or submission. Petitioner and Respondents have filed Blanket Consents to the filing of *amicus curiae* briefs with the Clerk of the Court.

who have served in the past as chair of the Association's Real Property, Probate and Trust Section, Taxation Section, or State and Local Taxes Committee. Their experience is not limited to representing taxpayers, some having worked in the past for the Washington State Department of Revenue as a former Assistant Director for Interpretation and Appeals, a second former appeals officer, and a legislative affairs officer. A full list of *amici* appears in Appendix A.

The Petitioner frames the Question Presented as whether due process restricts the power of states to "tax[ ] trusts." The question as posed is not inherently limited to income taxation. Practitioners hope that, informed by experience that cuts across the multiple forms of state taxes, their views may assist the Court in this case.

SUMMARY OF ARGUMENT

1. The Petitioner's argument boils down to two points. First, the Petitioner asserts it is fair to tax a trust based solely on the in-state residence of a beneficiary because of the "inseparable relationship" between a beneficiary and the trust. Pet. Br. at 36. "[W]hen a trust beneficiary lives in a state, so does her trust." *Id.* at 34.

Second, the Petitioner asserts that it would be unfair *not* to tax the trust because otherwise the beneficiary would be a "free rider" on the publicly funded services of North Carolina government. "North Carolina gave Ms. Kaestner the opportunity to send her children to the state's excellent public schools at no charge." *Id.* at 35. "North Carolina

shouldered [the] responsibility [to provide for the beneficiaries' health and welfare] by giving Ms. Kaestner and her children all of the critical public-safety services needed to protect their health and welfare." *Id.* Unless the state is allowed to tax the trust's income, "beneficiaries like Ms. Kaestner could live in their home states, consume state resources, and accept other protections from the state on a tax-free basis." *Id.* at 40.

Practitioners believe the Petitioner has it wrong on both counts. As to the first point, the Petitioner urges this Court to adopt a legal "formalism" – a one-to-one equivalency of trust and beneficiary for jurisdiction purposes – of exactly the kind that the Petitioner otherwise urges the Court to reject. The facts of this case, and other examples in Practitioners' experience, show by contrast that trusts are idiosyncratic. They can be imbued with values and purposes other than, and more complex than, the current welfare of the current beneficiary. To adopt the Petitioner's blanket rule, "the trust always resides in the same state as the beneficiary," would itself be arbitrary and capricious.

As to the second point, the insinuation that Ms. Kaestner has enjoyed North Carolina public services "on a tax-free basis" is unfair and contrary to the record. From all that appears, Ms. Kaestner's family has made more than ample contributions to the state's fisc and the welfare of the community.

2. The record shows that the trustee in this case has made no meaningful efforts, either in generating income or managing assets, to "purposefully direct" his activities to North Carolina

or to "purposefully avail" himself of the benefits that the state government affords. Practitioners fully support the Respondent's position that these formulations express the "irreducible due process requirement" for state jurisdiction over a nonresident, whether for tax or other purposes. Resp. Br. at 34; *see id.* at 33-35.

However, if the Court is inclined to entertain the Petitioner's claim that it is fair to assess tax liability against a trust based on its inherent relationship with beneficiaries, the Court should recognize that the quality of that relationship varies according to the powers and privileges the beneficiary enjoys internal to the trust. This Court's precedents concerning when trust assets may be included in a beneficiary's taxable estate upon death provide a ready analogy for determining when a beneficiary is sufficiently in control of the trust to identify the trust with her for tax purposes.

In *Curry v. McCanless*, 305 U.S. 347 (1939), the Court famously held that the Due Process Clause does not prohibit taxing trust assets twice, under two states' transfer taxes, if the power to tax is otherwise present. More importantly for the present case, the Court said why each state had the power to include trust assets in the taxable estate. Tennessee, the deceased trust beneficiary's state of residence, could include the assets in the taxable estate because the beneficiary held a general power of appointment, which the Court treated as tantamount to full ownership of the assets. *Id.* at 371-72. Alabama, where the trustee held the assets in question, could impose its transfer tax because of the control over the

assets held by the trustee. *Id.* at 370. In each state, a resident held a power or privilege to which the transfer tax could obtain. *See also Whitney v. State Tax Comm'n of New York*, 309 U.S. 530, 538 (1940) (beneficiary's privilege of determining property succession is the taxable privilege).

This Court moreover found it could make no distinction between jurisdiction to impose a direct tax on property and jurisdiction to impose an indirect tax on the same property. Thus the fact that Alabama could impose a property tax on trust assets legally owned by the trustee justified including those assets in the measure of Alabama's inheritance tax. *Curry*, 305 U.S. at 370.

The converse principle is aligned with and supports continued application of this Court's decisions in the direct-tax cases. If the beneficiary does not hold sufficient power, privilege, or control with respect to trust assets to subject the trust assets to tax upon her death, then her state of residence has no claim to tax undistributed trust income held by a remote trustee merely because of in-state residence. If the beneficiary and trustee know that, under privilege-tax analysis, trust assets could not be included in the beneficiary's estate upon death, how could they have had fair notice that undistributed income would be taxable in the beneficiary's state of residence during her life?

ARGUMENT

I. The Petitioner's "Fairness" Arguments Are Formalistic and Arbitrary; Trusts Are Not Uniform and Beneficiaries Cannot Be Presumed to Consume State Resources Without Making Their Own Tax Contributions.

A. The Petitioner's proposed rule – "Where the beneficiary resides, so does her trust" – arbitrarily ignores the flexibility of the trust structure and the diversity of values and purposes embodied in them.

The Petitioner argues that the beneficiary is the central constituent of the trust relationship and asserts that a trust "exists solely 'for the benefit of its beneficiaries.'" Pet. Br. at 29 (quoting Unif. Trust Code § 40 (Unif. Law Comm'n 2000)). This "inseparable relationship" between beneficiary and trust supplies the "minimum connection" between the remote trustee and the beneficiary's state of residence. *Id.* at 36. The proposed rule of decision is, "when a trust beneficiary lives in a state, so does her trust." *Id.* at 34.

The Petitioner paints a grossly static and uniform portrait of trusts in the United States. The Brief *Amicus Curiae* for the American College of Trust and Estate Counsel ("ACTEC Brief"), pages 7 to 9, by contrast, enumerates the variety of forms of shared beneficial interests accommodated by the trust structure. It is obvious that not all beneficiaries are equal. Beneficiaries have diverse claims upon trust assets and income.

Two examples from Practitioners' own clientele illustrate how the trust can embody values and purposes that are not captured by the rote recitation that a trust exists solely for the benefit of its beneficiaries. The first example represents one family's solution to the excruciating problem of a child's drug addiction. During their lives, the parents intended to assist their son in becoming stable and sober directly, but in the event of death they established a testamentary trust that reflected a "tough love"/no-waste perspective. As beneficiary, the son would become eligible for income distributions if he proved he was "clean" through a number of repeated, random drug tests, and would remain eligible only if he again tested "clean" when called for testing. The trust provisions of the will provided that, if he was not "clean" as of a certain age, his status as beneficiary would terminate, and the contingent remainder beneficiaries (his children, if any, or his nieces and nephews) would then become current beneficiaries. In a real sense, this trust was designed to avoid creating a unity of interest between trust and beneficiary, and instead potentially to prefer remote beneficiaries. Even if the trustee could be said to be purposefully availing itself of a state's civilized society where the drug testing might occur (should the son submit to it), this would not necessarily have been the state of the beneficiary's residence. The Petitioner's one-size-fits-all formula does not reasonably apply to this trust.

A more common situation involves second marriages. When a person has children in a first marriage and then remarries, the motivation is frequently to preserve assets for the children rather

than expend them for the surviving second spouse. Thus the trust might entail provisions allowing the trustee to distribute income to the surviving second spouse as beneficiary if necessary or desirable for the survivor's comfort, but to deny the survivor any power of appointment and to guarantee eventual distribution of trust corpus to the children of the first marriage. This structure has in fact been used by clients in Practitioners' experience. It makes no sense to say that, where the surviving spouse resides, so does the trust. The remainder beneficiaries have greater weight in the trust relationships in this situation. The surviving spouse's movements around the country or internationally cannot fairly trigger tax jurisdiction over trust income or property automatically wherever he or she lands.

The facts of the present case also reveal dynamics that disprove the reasonableness of the Petitioner's proposed rule of decision. The trustee had unfettered discretion to reallocate beneficial interests completely among an extended family of beneficiaries, even to exclude individual beneficiaries from distributions. *See* App. 50. The trustee never disclosed the existence of the Trust to Ms. Kaestner, and she learned about it only when her father informed her 15 years after the Trust's creation. App. 84. How could the Trust reside where Ms. Kaestner resided when it was kept a secret from her?

The Petitioner's rule of decision arbitrarily disregards the multiform dynamics that families choose to embody in the trust structure. It would be a formalistic rule *par excellence*. The Petitioner rightly reminds the Court on its history of avoiding

formalism, *e.g.*, Pet. Br. at 2, but itself falls into a formalistic trap. The due process rule must take into account the specific circumstances of the trust and beneficiaries in question. *See Rush v. Savchuk*, 444 U.S. 320, 332 (1980) ("The requirements of *International Shoe*,[2] however, must be met as to each defendant over whom a state court exercises jurisdiction."), *quoted in Walden v. Fiore*, 571 U.S. 277, 286 (2014).

B. The Court should not allow false insinuations that the Beneficiary is a "free rider" on public resources to influence constitutional analysis.

The Petitioner's Brief is laced throughout with insinuations that the Beneficiary would get something for nothing if the decision below were not reversed. "North Carolina offered [Ms. Kaestner and her children] wide-ranging protection and services—benefits that spared the Trust from having to pay for equivalent services. Those benefits and protections made it only fair for North Carolina to demand a return in the form of trust-income taxes." Pet. Br. at 17. If "beneficiaries like Ms. Kaestner" could select out-of-state trustees in reliance on the decision below, the Petitioner argues, they "could live in their home states, consume state resources, and accept other protections from the state on a *tax-free basis*." *Id.* at 40 (emphasis added).

From all that appears in the record, this is a baseless claim. The Brief of Respondent states that

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[2] *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

Ms. Kaestner's family has paid North Carolina tax on the income they received and controlled. Resp. Br. at 45. This Court can also presume that, contrary to the Petitioner's insinuation, Ms. Kaestner's family supported North Carolina's state and local governments through the other tax regimes maintained there – property tax, sales tax, and other excise taxes. *See, e.g.*, N.C. Gen. Stat. §§ 105-271 *et seq.* (property tax), 105-164.4 *et seq.* (sales and use taxes), 105-187.1 *et seq.* (highway use (motor vehicle) tax); *see generally* N.C. Gen. Stat. ch. 105 (taxation). These contributions follow from the family's situation, as the trustee in this case testified: "They were not looking for distributions of income from the Trust. Indeed Ms. Kaestner's husband is quite a successful businessman." App. 105.

Moreover, the family's contributions to North Carolina's well-being are not limited to taxation. The record shows "[t]hey are very active [in] Durham Cares," App. 104, a faith-based, multi-ethnic community building organization in their home city of Durham. *See* https://www.durhamcares.org/.

The Petitioner's implicit disparagement of Ms. Kaestner as a free rider is an unfortunate tactic. It stains the Petitioner's pose of seeking what it alleges is "only fair." Pet. Br. at 17. This Court should not rely on the Petitioner's reckless and arbitrary imputation in weighing the constitutional values presented by this case.

As residents of Washington State, Practitioners also know personally that there is no necessary or constitutional linkage between paying an income tax and making fair contributions to the functions of

government. Washington has no personal or corporate income tax. Consequently, North Carolina might argue that billions of dollars of income go "untaxed" in this state. But Washington citizens are not free riders; we pay tax according to the tax system arranged by the legislature and the voters at large, *see* Wash. Rev. Code titles 82 (excise taxes) and 84 (property tax), and as constrained by the state and federal constitutions. *See, e.g., Mahler v. Tremper*, 243 P.2d 627 (Wash. 1952) (upholding validity of tax on real estate sales as an excise tax); *Harbour Vill. Apartments v. City of Mukilteo*, 989 P.2d 542 (Wash. 1999) (invalidating local tax on rental dwelling units as non-uniform property tax). Constitutional limits on state taxing power do not impugn the character of citizens who do not pay an unlawful tax.

II. If The Court Is Inclined to Accommodate Tax Jurisdiction Based on the Trust-Beneficiary Relationship and Not the Volitional Acts of the Trustee, the Powers and Privileges Enjoyed by the Beneficiary Should Be the Key Consideration.

The contested issue in the case is whether, as the Petitioner argues, the Due Process Clause permits the exercise of tax jurisdiction over a remote trustee simply because of the fiduciary relationship between the trustee and the resident beneficiary or, as the Respondent argues, due process permits tax jurisdiction over the trustee only if the trustee, by his own actions, has purposefully availed himself of the privilege of conducting activities within the taxing state. *Compare* Pet. Br. at 16-17, 29-30, 36, *with* Resp. Br. at 12-13, 23-27, 32-34.

The record shows that the trustee in this case has made no meaningful efforts, either in generating income or managing assets, to "purposefully direct" his activities to North Carolina or to "purposefully avail" himself of the benefits that the state government affords. Indeed, the Petitioner has made no claim that the Trust or the trustee "purposefully availed" himself of the market or civilized society supported by North Carolina, as noted in the Respondent's brief. *See* Resp. Br. at 13. Two *amici curiae* do attempt to elide the differences between the parties, claiming that the trustee had a "purposeful" orientation toward North Carolina, but they do not rely on any volitional choices made by the trustee to obtain benefits provided by North Carolina. Instead, the *amici* simply apply the label "purposeful" to the trustee's connection to North Carolina, though that connection is incidental to the trust structure rather than voluntary. *See* Br. of Tax Law Professors at 8; Br. of Constitutional Law Scholars at 9. Their position is the same as the Petitioner's, but with a different label, and their usage obscures rather than clarifies the issue.

Practitioners fully support the Respondent's position that a remote person's volitional actions oriented toward enjoying the benefits of the taxing or forum state constitute the "irreducible due process requirement" for state jurisdiction over the nonresident, whether for tax or other purposes. Resp. Br. at 33; *see id.* at 32-34. Practitioners also join in the concerns expressed in the ACTEC Brief that adopting the Petitioner's position would threaten disruption of jurisdictional law far beyond income taxation. *See* ACTEC Br. at 32-35. To paraphrase

from a personal-jurisdiction decision, "What is needed—and what is missing here—is a connection between [North Carolina] and the [production or enjoyment of the income] at issue." *Bristol-Myers Squibb Co. v. Superior Ct. of California*, 137 S. Ct. 1773, 1781 (2017).

If the Court is inclined, however, to entertain the Petitioner's claim that it is fair to assess tax liability against a trust based on its inherent relationship with beneficiaries, the Court should recognize that the quality of that relationship varies according to the powers and privileges the beneficiary enjoys internal to the trust. The Petitioner asks the Court to adopt a uniform, formalistic, arbitrary picture of the trustee-beneficiary relationship—a picture that does not reflect realities. Due process requires a more individualized template.

The Respondent appropriately points the Court to its precedents concerning when a state may impose a direct tax on trust property or income with reference to the in-state residence of the beneficiary or trustee. Resp. Br. at 16-23 (discussing *Brooke v. City of Norfolk*, 277 U.S. 27 (1928); *Safe Deposit & Trust Co. of Baltimore, Md. v. Commonwealth of Virginia*, 280 U.S. 83 (1929); *Guaranty Trust Co. of New York v. Commonwealth of Virginia*, 305 U.S. 19 (1938); *Greenough v. Tax Assessors of City of Newport*, 331 U.S. 486 (1947)). Whether the in-state beneficiary or trustee has possession, control, or enjoyment of the property or income is the key to these direct-tax decisions. Resp. Br. at 22-23.

To validate the fairness of this standard, the Court may consult its decisions in the analogous area

of indirect taxes, specifically estate and transfer taxes. The Court has had several occasions to determine when trust assets may be included in a beneficiary's taxable estate upon death. These decisions provide a ready analogy for assessing whether a beneficiary is sufficiently in control of trust property to identify the trust with her for tax purposes.

The decision in *Curry v. McCanless*, 305 U.S. 347 (1939), is most renowned for the Court's conclusion that the Due Process Clause does not prohibit taxing the value of trust assets twice, under two states' transfer taxes, if the power to tax is otherwise present. *See, e.g.*, Pet. Br. at 28 n.12. More importantly for the present case, the Court in *Curry* said *why* each state had the power to include trust assets in the taxable estate. Tennessee was the deceased trust beneficiary's state of residence. The Court said Tennessee could include the trust assets in the taxable estate because the beneficiary held a general power of appointment, which the Court treated as tantamount to full ownership of the assets. *Curry*, 305 U.S. at 371-72. Alabama was where the trustee held the assets in question. The Court said Alabama could impose its transfer tax because of the control over the assets held by the trustee. *Id.* at 370. In each state, a resident held a power or privilege to which the transfer tax could attach.

Indeed, on the Alabama question this Court reasoned by analogy in the way suggested here. Alabama had power to impose a direct tax (a property tax) on the assets held by the trustee in that state. *Id.* (citing *Safe Deposit*). Since this was true, the Court

said, "we perceive no ground for saying that the Fourteenth Amendment forbids the state to tax the transfer of it or an interest in it to another . . . ." *Id.*

The converse analysis fully supports the Respondent's position. The estate tax is an excise tax, *see Knowlton v. Moore*, 178 U.S. 41, 47, 81 (1900), that depends on the decedent's transfer of property on death, and the existence or exercise of a privilege with respect to trust property is essential to the inclusion of trust property in a decedent beneficiary's estate. The power to determine the succession and enjoyment of property "is precisely the privilege which the state confers and upon which it seizes for the imposition of a tax." *Whitney v. State Tax Comm'n of New York*, 309 U.S. 530, 538 (1940) (upholding state estate tax on trust corpus where lifetime trust beneficiary exercised power of appointment).

If, however, the beneficiary was not the grantor of the trust and lacks a power, privilege, or control with respect to trust assets, there is no taxable transfer upon death. The federal estate tax captures in the "gross estate" the value of "all property *to the extent of the interest therein of the decedent* at the time of his death." 26 U.S.C. § 2032 (emphasis added). Consistent with this Court's decisions, however, *see Curry*, 305 U.S. at 371, a lifetime beneficiary of a trust created by another person is not deemed to have a taxable interest in trust property unless the beneficiary holds a general power of appointment as defined in 26 U.S.C. § 2041.[3]

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[3] A transfer tax imposed on the receipt of inheritances, on the other hand, may be imposed on the value of trust assets received

If a trust beneficiary lacks sufficient interest in trust property via the terms or operations of the trust to subject the trust assets to transfer tax upon her death, then her state of residence should have no claim to tax undistributed trust income merely because of the in-state residence. From a due-process, fair-notice perspective, if the beneficiary and trustee know under these principles that the beneficiary holds an insufficient interest in trust assets to include them in the beneficiary's estate upon death, they could not have had fair notice that undistributed income owned by a remote trustee would be taxable in the beneficiary's state of residence during her life.

If, therefore, this Court is inclined to weigh the jurisdictional claims of a state to tax the undistributed income of a foreign trust in part based on the in-state residence of a beneficiary, the question whether the beneficiary holds rights and powers internal to the trust sufficient to include trust assets in the beneficiary's taxable estate is aligned with and supports continued application of the Court's precedents involving direct taxation of trust property and income.

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by a remainder beneficiary. *See West v. Oklahoma Tax Comm'n*, 334 U.S. 717 (1948). Such a tax does not rely on the character of the decedent beneficiary's interest in the trust property.

CONCLUSION

For the foregoing reasons, *Amici Curiae* Washington State Tax Practitioners respectfully request that the Court affirm the decision below.

Respectfully submitted,

DIRK GISEBURT*
DAVIS WRIGHT TREMAINE LLP
920 Fifth Avenue
Suite 3300
Seattle, WA 98104
(206) 757-8049
dirkgiseburt@dwt.com

Counsel for *Amici Curiae*

* Counsel of Record

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APPENDIX

APPENDIX A

LIST OF *AMICI CURIAE* WASHINGTON STATE TAX PRACTITIONERS

Norman J. Bruns
Garvey Schubert Barer P.C.
Seattle, Washington

Michelle DeLappe
Garvey Schubert Barer P.C.
Seattle, Washington

James A. Flaggert
Davis Wright Tremaine LLP
Seattle, Washington

Garry G. Fujita
Eisenhower Carlson PLLC
Tacoma, Washington

Dirk Giseburt
Davis Wright Tremaine LLP
Seattle, Washington

Richard A. Klobucher
Davis Wright Tremaine LLP
Bellevue, Washington

Douglas C. Lawrence
Stokes Lawrence, P.S.
Seattle, Washington

George C. Mastrodonato
Carney Badley Spellman, P.S.
Seattle, Washington

Michele G. Radosevich
Davis Wright Tremaine LLP
Seattle, Washington